IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

RAYMOND H. BERRY,
A. H. MOORMAN,
JOHN L. KING,
1000 Penobscot Building,
Detroit 26, Michigan,
Attorneys for Petitioner.

Of Counsel:
ELLSWORTH C. ALVORD,
LINCOLN ARNOLD,
World Center Building,
Washington 6, D. C.

INDEX

CITATIONS

Cases (continued): Page

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 144-169) are reported at 20 T. C. 1033. The opinion of the Court of Appeals (R. 190-219) is reported at 230 F. 2d 585.

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1956 (R. 190). The petition for a writ of certiorari filed on May 15, 1956, was granted on October 8, 1956 (R. 219). The jurisdiction of this Court rests upon 28 U. S. C., section 1254.

QUESTIONS PRESENTED

I. Membership Dues

Was the petitioner, reporting on the accrual basis, entitled to report prepaid membership dues as income when earned, rather than when received, in accordance with the method of accounting regularly employed by petitioner in keeping its books?

II. Retroactive Revocation of Tax Exempt Status

Did the Commissioner of Internal Revenue in 1945 act arbitrarily and without authority in revoking *with retroactive effect* the rulings previously made by a predecessor Commissioner which held that petitioner was exempt from taxation, when there had been no change in the law or in the character and operation of the petitioner as a club?

III. Statute of Limitations

If the retroactive revocation of petitioner's exemption was not invalid, did the statute of limitations bar the assessment of the deficiencies asserted for the years 1943 and 1944?

STATUTES AND REGULATIONS INVOLVED

The statutory provisions and regulations involved are as follows:

With respect to Question I, section 41 and section 42(a) of the Internal Revenue Code of 1939; sec. 29.41-1 and sec. 29.41-3 of Treasury Regulations 111.

With respect to Question II, section 101 (9) and section 3791(b) of the Internal Revenue Code of 1939; Art. 101-1 of Treasury Regulations 86, Art. 101-1 of Treasury Regulations 94, and sec. 29.101-1 of Treasury Regulations 111.

With respect to Question III, section 52 (a), section 54 (f), section 275 (a), and section 276 (a) and (b) of the Internal Revenue Code of 1939.

These provisions are printed in Appendix A, *infra*, pages 1a through 11a.

STATEMENT

The facts with respect to the issues are as follows:

Preliminary

The petitioner was incorporated under the laws of the State of Michigan on July 21, 1916, as a non-profit organization (R. 16). It has never had capital stock, and none of its earnings have been, or can be, distributed to its members. In the event of dissolution, petitioner's funds must be distributed to one or more non-profit organizations devoted to one or more of the purposes of petitioner or to one or more educational or charitable organizations

to be selected by the Board of Directors (Exhibit 2 to Stipulated Facts; R. 16, 42). The functions of petitioner are carried out by its officers and employees under the direction of a Board of Directors which is elected annually. The members of the Board of Directors serve without compensation (R. 16).

Petitioner renders various services to its members. Some of the services are of a direct and immediate benefit to the member, such as emergency road service when his car is disabled, the receipt from petitioner of maps, road and other travel information, and a monthly magazine containing news of travel and of laws pertaining to the use of automobiles (R. 124-125).

Many services rendered by petitioner for the benefit of its members are of a civic nature. Petitioner engages in the promotion of safety and in the elimination of traffic problems, including the advocacy of reasonable and useful traffic laws and ordinances. Petitioner pioneered the promotion of schoolboy patrols and its plan was adopted on a national scale. The petitioner has annually conducted seminars at the University of Michigan, for the education of school teachers in the state in driver training courses. Petitioner has promoted, and furnished without charge to various communities, the proper directional and "stop" signs for roads and highways. Petitioner tries to do for the motorist in a collective way that which he is unable to do as an individual (R. 126).

I. Membership Dues

For the services rendered by petitioner, members paid annual dues which accounted for approximately 95% of petitioner's gross income (Ex. 11 to Stipulated Facts; R. 19, 68c). The dues were paid in advance for a 12 month period, and petitioner received dues in every month of the

year. A member paid his dues, not for past services rendered, but for services to be rendered to him by petitioner during the 12-month period following the payment of the dues. In the case of membership dues paid in December of any year, 11/12ths of the petitioner's services and expenses with respect to such dues were incurred in the following calendar year (R. 129, 130).

During all the years involved in this proceeding, and for many years prior thereto, petitioner recorded its income and disbursements in its books and records on a calendar-year basis and upon the accrual method of accounting. It filed all tax returns for the years involved in this proceeding in accordance with the method by which it kept its books—on the accrual method.

Under petitioner's accrual method of accounting, the dues received from a member were recorded by petitioner in its books in an account designated as "Unearned Membership Dues." Each month as the dues were earned petitioner transferred 1/12th of the amount of the dues from the "Unearned Membership Dues" account to an account designated on its books as "Membership Income". Thus, if a member paid his dues in December 1945, petitioner's books recorded only 1/12th of the dues as income for 1945, and 11/12ths of the dues were recorded as income for the year 1946. The amount carried in the "Unearned Membership Dues" account was carried on petitioner's books as a liability (R. 128).

The petitioner consistently maintained a policy of refunding on a prorata monthly basis the unearned membership dues in the case of the termination of a membership by reason of the death or resignation of the member or for any other reason. During the years 1943 to 1947, petitioner made refunds due to cancellation of memberships in the amount of $90,691.62 (R. 142).

Petitioner adopted its method of accounting for dues on the recommendation of its accountants as the sound and proper accounting method of treating prepayments of membership dues (R. 129, 130). The purpose and function of the method was to have the income earned during an accounting period charged with the expenses attributable to that income. The method was not adopted for tax reasons. It was adopted during the period when the Commissioner had ruled that petitioner was exempt from taxation. This method of accounting for membership dues was consistently followed by the petitioner for the years ending December 31, 1934 to December 31, 1947, inclusive.

II. Retroactive Revocation of Tax Exempt Status

During the early part of 1934, the petitioner inquired of respondent whether it was exempt from payment of the capital stock tax imposed by section 215 of the National Industrial Recovery Act (R. 16, 17). By letter dated May 16, 1934 the respondent wrote to petitioner in reference to the inquiry and stated that in order to determine whether petitioner was exempt from the capital stock tax, "the Bureau must first determine whether you are entitled to exemption from Federal income taxation under the provisions of section 103 of the Revenue Act of 1932." (Ex. 3 to Stipulated Facts; R. 17, 44.)

In his letter of May 16, 1934, the respondent requested petitioner to supply in affidavit form a detailed explanation of its activities, the sources from which its income was derived, the disposition made of such income, facts relative to whether or not it paid interest or dividends on its capital stock, facts with respect to whether any of its income was credited to surplus or might inure to the bene-

fit of any private shareholder or individual, and all other relevant facts relating to its activities which might affect its status (R. 44-45).

Petitioner, by a statement sworn to by its Assistant Treasurer, submitted to the Commissioner all of the information and data requested, including a financial statement as of April, 1934 (Ex. 4 to Stipulated Facts; R. 17, 45-47). On the basis of this information, Commissioner Guy T. Helvering (by his Deputy Commissioner) made his first determination that the petitioner was exempt from taxation, and by a letter dated June 11, 1934[1] notified the petitioner of that determination, and stated further:

---

[1] Following is the full text of the letter of June 11, 1934, with emphasis supplied (Ex. 5 to Stipulated Facts; R. 17, 48-49).

EXHIBIT 5

June 11, 1934.

IT:E:RR
CQ

Automobile Club of Michigan,
139 Bagley Avenue,
Detroit, Michigan.

Sirs:

Reference is made to the evidence submitted by you in support of your claim to exemption from Federal income taxation.

The evidence submitted discloses that the Detroit Automobile Club was incorporated under the laws of the State of Michigan in 1916 and that the name of the organization was changed to the Automobile Club of Michigan in 1931. You were formed "to promote and foster the healthy growth of the automobile industry; to secure the adoption and endorsement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of 'Safety First' as applied to automobile traffic; to promote touring and to

(Continued on following page)

"You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101 (9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business."

(Continued from preceding page)

obtain and furnish touring information and the necessary sign boarding of public highways; and to co-operate in any work or movement which may tend to benefit the automobile driver, user, owner or manufacturer, and the automobile industry in general."

Your assistant treasurer in an affidavit states that your activities consist of a touring service, such as logs, road maps, general touring information to members; emergency road service such as starting of members' disabled cars on the road, towing cars to official club garages, changing tires, etc.; the publication of the Michigan Motor News, a monthly magazine published for your members only; and the employment of several men to work in public schools in cooperation with various cities of the state to promote safety and to improve traffic conditions. It is stated that you cooperate in any work or improvement which tends to benefit the automobile driver, user, owner, or manufacturer, and the automobile industry in general; that your income is derived from membership dues, sale of advertising in your publication, and interest on funds; that you do not pay interest or dividends; and that you have no capital stock. Your financial statement discloses that your income is used to defray executive, legal, touring, emergency road service, safety and traffic signs, and miscellaneous operating expenses.

Based on the foregoing, it is held that you are entitled to exemption under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts. You are not, therefore, required to file returns for 1933 and prior years and it follows that future returns, under the provisions of section 101(9) of the Revenue Act of 1934, will not be required so long as there is no change in your organization, your purposes or methods of doing business.

(Continued on following page)

About three years later, on September 29, 1937, respondent sent petitioner a questionnaire calling for information as to petitioner's right to exemption under section 101(9) of the Revenue Act of 1936. Petitioner filled in the questionnaire, sworn to by its Treasurer, and returned it to the respondent with a letter of transmittal dated October 27, 1937, together with a copy of its financial statement as of December 31, 1936 (Ex. 6 to Stipulated Facts; R. 17, 50-58). On the basis of that information, Commissioner Helvering (by his Deputy Commissioner) determined for the second time that the petitioner was ex-

---

(Continued from preceding page)

Any changes in your form of organization or method of operation, as shown by the evidence submitted, must be immediately reported by you to the collector of internal revenue for your district, in order that the effect of such changes upon your present exempt status may be determined.

The exemption granted in this letter does not apply to taxes levied under other titles or provisions of the respective revenue acts, except in so far as exemption is granted expressly under those provisions to organizations enumerated in section 103 of the Revenue Act of 1932.

A copy of this letter is being transmitted to the collector of internal revenue for your district.

By direction of the Commissioner.

Respectfully,

(Signed) Chas. T. Russell
Deputy Commissioner.

CQ/OEL-1

empt from income taxation and by a letter[2] dated July 5, 1938, advised the petitioner:

> "*Careful consideration has been given* to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status *the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936.*" (Emphasis supplied.)

---

[2] Following is the full text of the letter of July 5, 1938 (Ex. 7 to Stipulated Facts; R. 59):

EXHIBIT 7

July 5, 1938

IT:RR:MM

Automobile Club of Michigan,
139 Bagley Avenue,
Detroit, Michigan.

Sirs:

Reference is made to the questionnaire and supporting data submitted in response to the request of the Bureau for the purpose of determining whether the exemption from income taxation under the provisions which now appear in Section 101 of the income tax law, to which you have heretofore been held to be entitled, is equally applicable under the Revenue Act of 1936.

Careful consideartion has been given to the evidence submitted and as it appears that there has been no change in your form of organization or activities which would affect your status the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed under the Revenue Act of 1936.

By direction of the Commissioner.

Respectfully,

(Signed) John R. Kirk,
Deputy Commissioner.

MM/ij-1

In reliance upon the ruling letters of June 11, 1934 and July 5, 1938, petitioner considered itself exempt from income taxation and, in literal compliance with the ruling letters, did not file income tax returns; except that after the enactment of section 54 (f) (a new provision, added to the Internal Revenue Code of 1939 by section 117 of the Revenue Act of 1943, requiring annual returns to be filed by certain tax-exempt organizations) petitioner did file annual returns on Form 990 for the calendar year 1943 and subsequent years. In further reliance upon the rulings, petitioner kept its books and managed its affairs on the assumption that it was exempt from taxation (R. 138).

The petitioner did not hear again from the respondent as to its tax exempt status until it received a letter dated May 12, 1945 in which it was stated that the Bureau *is now reconsidering* the tax exemption of automobile associations in the light of an opinion rendered in 1943 by the Chief Counsel of the Bureau of Internal Revenue. This letter[3] transmitted Treasury Form 1025, the exemption

---

[3] Following is the full text of the letter dated May 12, 1945 (Ex. 7 to Stipulated Facts; R. 8, 59-60):

EXHIBIT A

May 12, 1945

IT:P:T-1
FDF

Automobile Club of Michigan
139 Bagley Avenue
Detroit, Michigan

Gentlemen:

Reference is made to Bureau ruling of June 11, 1934, holding you entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

(Continued on following page)

affidavit for use of organizations claiming exemption from taxation under section 101 (9) of the Internal Revenue Code of 1939, and requested that the form be filed within 30 days. The letter stated that the information requested in Item 8 of the form, concerning the specific activities of the petitioner, should cover the last complete year of operation. No request was made with respect to petitioner's activities for prior years.

(Continued from preceding page).

The Bureau is now reconsidering the question of the exemption of automobile associations from Federal income tax in the light of the opinion of the Chief Counsel of the Bureau of Internal Revenue in regard thereto as set forth in G. C. M. 23688, C. B. 1943, 283.

It is therefore requested that you fill in all the information outlined on the enclosed Form 1025. Attention is called to the data requested in item 15. The classified statement of the receipts and expenditures referred to thereon should be submitted but it will not be necessary for you to furnish copies of your articles of incorporation and bylaws as copies thereof are on file in this office. However, if any changes have been made thereon, a copy of such amendments and the authorization therefor should be furnished.

The information requested in item 8 should cover all your actual activities during your last complete year of operation.

The above information should be furnished the Bureau within thirty days from the date of this letter, marked for the attention of IT:P:T-1-FDF.

Very truly yours,

Norman D. Cann
Deputy Commissioner

By (Signed) L. K. Sunderlin
Chief of Section

Enclosure:

Form 1025
FDFoley/em-3
5-5-45

Before the expiration of the 30-day period, petitioner completed and mailed Form 1025 to the Commissioner, giving him all the information requested. On the basis of that information, Commissioner Joseph D. Nunan (by a Deputy Commissioner) sent a letter dated July 16th, 1945 in which he ruled that the petitioner was not exempt from taxation under section 101 (9) of the Internal Revenue Code of 1939. In addition, the letter[4] specifically revoked the prior rulings of June 11, 1934 and July 5, 1938 which held that the petitioner was exempt from taxation, and the letter ordered petitioner to file income tax returns retroactivity for the year 1943 and 1944.

---

[4] Following is the full text of the letter of July 16, 1945 (Ex. B to Stipulated Facts; R. 18, 66-67), with emphasis supplied.

EXHIBIT B

July 16, 1945

IT:P:T:1
FDF

Automobile Club of Michigan
139 Bagley Avenue
Detroit 26, Michigan

Gentlemen:

Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed in G. C. M. 23688; C. B. 1943, 283.

Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103(9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.

The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in

(Continued on following page)

Not until the petitioner received the letter of July 16, 1945 was it advised or informed that Commissioner Nunan (or any of his deputies) had determined that petitioner was no longer exempt from taxation. Not until receipt of this letter was the petitioner advised that it could no longer rely on the ruling letters of June 11, 1934 and July 5, 1938. At no time prior to July 16, 1945 did the Commissioner advise petitioner that it must, despite the prior ruling letters, file income tax returns for 1943 and subsequent years.

(Continued from preceding page)

public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members.

Section 101(9) of the Internal Revenue Code provides for the exemption of:

> "Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

Prior revenue acts carry similiar provisions.

This office holds that the term "club" as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term "club".

The evdence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

It is, accordingly, held that you are not a club "organized and operated exclusively for pleasure, recreation and other nonprofitable purposes", within the meaning of section 101(9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore,

(Continued on following page)

The retroactive revocation in 1945 of the determinations made by the prior Commissioner in 1934 and 1938 with respect to petitioner's tax exemption was not based on any intervening change in the statute or in the manner in which petitioner conducted its activities, or on any misrepresentation, concealment, or fraud on the part of the petitioner. The revocation was based solely on Commissioner Nunan's opinion that the previous determinations and rulings rendered to petitioner were erroneous, since fellowship between the petitioner's members did not play a material part in the life of the organization.

Petitioner at the time of the hearings before the Tax Court, and in its Brief to the Tax Court, conceded that the Commissioner's ruling of July 16, 1945 could be applied with prospective effect so as to subject petitioner to tax for taxable years ending after the date it received the letter of July 16, 1945. But petitioner at all times has denied any validity to the attempt to revoke retroactively the specific rulings received by petitioner in 1934, and

---

(Continued from preceding page)

are not entitled to exemption under those sections. Furthermore, there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years.

By direction of the Commissioner.

Very truly yours,

(Signed) Norman D. Cann
Deputy Commissioner

FEF/mes-z
7-7-45

again in 1938, that it was exempt from taxation and exempt from filing income tax returns so long as there was no change in its form of organization or activities.

III. Statute of Limitations

The due date for filing an income tax return for the calendar year 1943 was on March 15, 1944 and the due date for filing a return for the calendar year of 1944 was on March 15, 1945. The petitioner did not file income tax returns for the calendar years 1943 and 1944 on or before the due dates, in view of the rulings which petitioner had received from the Commissioner exempting it from filing income tax returns.

The petitioner on August 12, 1944 and on May 17, 1945, as required by section 54 (f) of the Internal Revenue Code of 1939, filed with the respondent in the Office of the Collector of Internal Revenue at Detroit, Michigan, annual returns on Form 990 for the calendar years 1943 and 1944, respectively (Ex. 21 to Stipulated Facts; R. 20, 95-105). Attached to each of said returns was a statement of petitioners gross income for the year, its disbursements therefrom, and a statement of its assets and liabilities for the year.

As requested in respondent's revocation letter of July 16, 1945, peitioner filed corporation income and declared value excess profits tax returns and corporation excess profits tax returns for the calendar years 1943 and 1944 on October 26, 1945 (R. 18-19). These returns were filed under protest, and each return showed no computation of tax on the ground of the exemption from tax (Ex. 13 to Stipulated Facts; R. 71-76; Ex. 14 to Stipulated Facts; R. 77-82; Ex. 15 to Stipulated Facts; R. 83-90; Ex. 16 to Stipulated Facts; R. 91-94).

With respect to the calendar year 1943, petitioner executed a Form 872 entitled "Consent Fixing Period of Limitation Upon Assessment of Income and Profits Tax" on August 23, 1948 and again on May 23, 1949 (Ex. C; R. 108-111). For the calendar year 1944, petitioner executed Form 872 on August 23, 1948 and again on May 23, 1949 (Ex. D; R. 112-115). The execution of the foregoing consents was requested by respondent for the purpose of extending the period of limitations upon the assessment of income and excess profits taxes for the calendar years 1943 and 1944 to June 30, 1950.

The respondent's statutory notice of deficiency for the years 1943 to 1947 inclusive was mailed to petitioner on February 2, 1950 (R. 2). While the statutory notice of deficiency with respect to the calendar years 1943 and 1944 was mailed to petitioner prior to June 30, 1950 (the limitations date set forth in the consents executed by the petitioner), the consent forms 872 for the years 1943 and 1944 were executed by petitioner subsequent to the expiration of three years from due dates for filing returns for 1943 and 1944, and also subsequent to the expiration of three years from the dates petitioner had filed with respondent returns on Form 990 for the calendar years 1943 and 1944.

SUMMARY OF ARGUMENT

I. PREPAID MEMBERSHIP DUES

Under section 41 of the Internal Revenue Code of 1939, petitioner is entitled to have its net income computed in accordance with the method of accounting regularly employed by it in keeping its books, unless that method did not clearly reflect income. Petitioner's method of accounting—under which prepaid membership dues are taken into income as earned—did clearly and correctly reflect its income. The method which the Commissioner seeks to substitute, the cash receipts method, demonstrably distorts petitioner's income.

Under petitioner's method of accounting, every single dollar of income was reflected in its books and, therefore, in its tax returns. The action taken by the Commissioner in petitioner's case is another illustration of his practice, which is exceeding all reasonable bounds, of disapproving accounting systems of long standing consistently applied by taxpayers, in an attempt by the Commissioner to collect in advance a tax which in due course will be paid tomorrow.

The Commissioner is in error in claiming that the "claim of right" doctrine, as applied by this Court in such cases as *Brown v. Helvering* (1934) 291 U. S. 193, justifies his rejection of petitioner's method of accounting. It is clear that this Court, without reversing or modifying any of its previous decisions with respect to "claim of right", can sustain petitioner's right to take prepaid membership dues into account for tax purposes in accordance with the method of accounting which petitioner adopted many years ago as best suited for its purposes. Moreover, the

Commissioner, in urging that petitioner's method of accounting violates the "claim of right" doctrine, is contending in effect that his regulations with respect to the treatment of prepaid income under long-term contracts, and other items, are invalid.

The repeal by Congress in 1955 of section 452 of the Internal Revenue Code of 1954, dealing with the tax treatment of prepaid income, did not indicate a Congressional approval of the Commissioner's position on prepaid income. Rather, Congress made it plain that it did not intend to disturb permissible accounting methods for prepaid income of the type involved in petitioner's case.

II. RETROACTIVE REVOCATION OF TAX EXEMPTION

An extreme case is presented when the Commissioner seeks to revoke, with retroactive effect, a ruling of tax exemption previously issued by him or by a predecessor Commissioner. Under the Commissioner's regulations, an organization claiming tax exemption is required to file an application for ruling so that the Commissioner can pass judgment upon the facts and law involved. When the Commissioner makes a determination—an administrative adjudication—that an organization is exempt from taxation, he advises the organization that it need not thereafter file tax returns so long as there is no change in its purposes or manner of operation.

Whatever the power of the Commissioner may be to revoke with retroactive effect other types of rulings issued to taxpayers, and rulings published in the Internal Revenue Bulletin which some taxpayer may have read and relied upon, it seems clear that the Commissioner should be held not to have power to revoke, with retroactive effect, a ruling of tax exemption in the circumstances presented by petitioner's case. It would be a step backward in the

current endeavors to maintain public faith and confidence in our system of voluntary self-assessment of income tax if taxpayers are informed by this Court that the Commissioner, with impunity, can violate basic rules of fairness and equity in administering the tax laws.

There is a dearth of cases concerning the right of the Commissioner to revoke individualized rulings with retroactive effect. Among the authorities in support of petitioner is a recent decision of the Third Circuit Court of Appeals in *Lesavoy Foundation v. Commissioner*, — F. 2d — (November 21, 1956), in which the Commissioner was denied the right to revoke retroactively a ruling of tax exemption.

The Commissioner contends that he always has the right to correct, retroactively, a mistake of law made by a predecessor. Even if that be correct as a general proposition, the facts of petitioner's case qualify it as a most proper exception to any such general rule. The tax exempt rulings which the petitioner received in 1934 and 1938 did not involve a mistake of law which was plainly erroneous or in conflict with express statutory provisions.

The regulations of the Commissioner during 1943 and 1944 advised petitioner that, having established its tax exemption pursuant to the mandate of regulations, it need not thereafter file income tax returns. The attempt of the Commissioner in 1945 to deny petitioner the protection of those regulations was a violation of the principle enunciated by this Court in *Helvering v. R. J. Reynolds Tobacco Co.* (1939) 306 U. S. 110.

The Commissioner's reliance on section 3791(b) of the Internal Revenue Code of 1939 (relating to retroactive application of regulations and rulings) is misplaced. That section is not an obstacle to a decision in petitioner's favor.

The petitioner in good faith relied on the tax-exempt rulings issued to it until July 16, 1945, the date of the revocation of those rulings. Petitioner's reliance was with unmistakable detriment if the Commissioner had the right, as he insists, to make the 1945 revocation applicable to years then already past.

III. STATUTE OF LIMITATIONS

If it is found that the Commissioner had the power to revoke petitioner's tax-exempt rulings with retroactive effect, the statute of limitations would not, under the opinion below, restrain the Commissioner from the assessment of deficiencies against petitioner without limitation, because petitioner in reliance on the tax exempt rulings did not file the tax returns required of taxable organizations. Petitioner urges two grounds on which it can be properly held that the statute of limitations bars the assessment of any deficiency for the years 1943 and 1944.

First, as two lower courts have held, the statute of limitations commences to run on the due date for the filing of a return where the failure of the taxpayer to file had been induced by the Commissioner.

Second, the filing of Form 990 (the information return required to be filed by certain tax-exempt organizations) constitutes a return for the purpose of the statute of limitations, at least in a case where the taxpayer had an exemption ruling stating that it need not file tax returns on the form required of taxable organizations.

The statute of limitations often works a hardship and applies generally without regard to equities, but in petitioner's case, if the Commissioner had power to retroactively revoke petitioner's tax exemption, the statute of limitations will serve equity and eliminate the unfairness which necessarily accompanies retroactivity.

ARGUMENT

I.

MEMBERSHIP DUES

The Petitioner Was Entitled to Report Prepaid Membership Dues as Income When Earned, Rather Than When Received, in Accordance with the Method of Accounting Regularly Employed by Petitioner in Keeping Its Books.

A. Petitioner's method of accounting clearly reflected its income.

Under the statute and the regulations, petitioner is entitled to have its net income computed in accordance with the method of accounting which was regularly employed by petitioner in keeping books, unless that method did not clearly reflect income. Section 41 of the Internal Revenue Code of 1939 provides:

> "The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income * * *."

Section 29.41 of Regulations 111, applicable to the years here involved, provides in part:

> " * * * The time as of which any item of gross income or any deduction is to be accounted for

> must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. *If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed* with respect to the time as of which items of gross income and deductions are to be accounted for * * *." (Emphasis supplied.)

Despite the method of accounting regularly employed by petitioner in keeping its books, under which membership dues were taken into income as earned, the Commissioner recomputed petitioner's income by treating membership dues as income as of the time received. Although petitioner kept its books by the accrual method of accounting and filed its tax returns on that basis, the Commissioner has placed the petitioner strictly on the cash-receipts method insofar as membership dues are concerned.

It is recognized that the Commissioner contends in petitioner's case (although not consistently with his position in other cases mentioned later) that an accounting method will not clearly reflect income unless it applies the "claim of right" doctrine—as understood by the Commissioner. The Commissioner's misunderstanding and misapplication of that doctrine, as enunciated by this Court,[5] is discussed later in this argument. But even though the Commissioner has mistaken notions as to what is included in the "claim of right" theory, the fact remains that he has rejected petitioner's method of accounting and substituted a method of his own. Under Section 41 of the Internal Revenue Code of 1939, the Commissioner has a right to compute petition-

---

[5] North American Oil Consolidated v. Burnet (1932), 286 U. S. 417; Brown v. Helvering (1934), 291 U. S. 193; and other cases discussed infra.

er's net income under such method as in his opinion is proper, but only if petitioner's method fails to reflect income clearly. Thus, even though the claim of right doctrine is inapplicable in petitioner's case, the question remains whether petitioner's method of accounting more clearly reflects income than the method the Commissioner would substitute.

Petitioner's method of accounting with respect to membership dues serves a simple but sensible purpose—the income in one accounting period should be offset in the same accounting period by the expenses incurred in earning that income. If a member paid his dues on July 1, 1945, petitioner performed services for the member during the last six months of 1945 and during the first six months of 1946, and therefore earned the income during two separate accounting periods. Approximately half of the total expenses over the 12-month period were incurred in 1945 and deducted in the income tax return for 1945, and the balance of the expense in earning the income was incurred and deducted during 1946. It is quite obvious that if the net income derived from those dues is to be correctly computed in each of the two years during which the money was earned, one-half of the dues should be returned as gross income for 1945 and one-half for 1946. Petitioner's method of accounting did just that.

Under the Commissioner's cash receipts method, 100% of the dues paid on July 1, 1945, would be included as gross income for 1945, even though only half of the expenses incurred in earning the dues were charged to 1945. That method clearly results in an absolute distortion of petitioner's earnings for both 1945 and 1946—an over-statement of the earnings for 1945, and an understatement of the earnings for the year 1946.

The patent correctness of petitioner's method of accounting, and the utter failure of the Commissioner's method to reflect income correctly in the case of prepaid dues, can be emphasized by a simple illustration. Let us assume the case of a new Automobile Club, organized in November 1956, which keeps its books on a calendar year basis. For the sake of simplicity, let us assume that 100 members joined the Club on December 1, 1956, and each paid $12.00 annual dues in advance. The Club expects to incur expenses of 95¢ per month per member on the average ($95 each month for the 100 members), or a total expense of $1140.00 for the 12-months period. A total taxable income of $60.00 would be realized out of the $1200.00 collected in December from the members, or a profit of $5.00 a month.

Under petitioner's method of accounting, the new Club would take $100.00 ($1 per member) into income for 1956, and after deducting expenses of $95.00 incurred in December 1956, it would have a net income of $5.00 for the year 1956 subject to tax. In the following year the remaining $55.00 of the income would be earned and taxed.

But, under the Commissioner's method of accounting, the new Club would be required to pay a Federal income tax for 1956 on a fictitious taxable income of $1105.00—$1200.00 dues collected in December 1956, minus $95.00 expenses incurred in that month. After paying the tax (on March 15, 1957) on that fictitious income, the new Club would not have enough money left to pay the monthly expenses of $95.00 as they are incurred during 1957 in rendering services to its 100 members.

Clearly, the statute does not require such a result. To the contrary, it expressly provides for reaching a proper result. Section 42 (a) of the Internal Revenue Code of 1939 (Appendix p. 1a) provides in part:

> "The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for *as of a different period.*" (Emphasis supplied.)

While an accrual basis taxpayer quite commonly and properly includes an item in income *before* the year of receipt, the phrase "as of a different period" includes a period *after* the year of receipt, as well as a period *prior* to the year of receipt. If the statute had intended to eliminate (as a proper period in which cash receipts might be reported as gross income) a year following the year of receipt, then the phrase in section 42(a) would have simply read "as of an earlier period" in lieu of "as of a different period."

Indeed, the Commissioner himself has recognized in other areas (discussed later, pages 41 to 42) that income under section 42(a) can be properly reported after the year of receipt in the case of long term contracts, prepaid subscriptions, and certain other items.

Petitioner's method of accounting reached the very result which this Court has ascribed to the accrual method of accounting. In *United States v. Anderson,* (1926) 269 U. S. 422, this Court stated:

> "It [the accrual method] was to enable taxpayers to keep their books and make their returns according to scientific accounting principles by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; * * *."

Furthermore, petitioner's method conforms to generally accepted accounting practices applied in the case of prepaid dues. In the Handbook of Accounting Methods (1943 edition, edited by J. K. Lasser), the section dealing with accounting methods for clubs and fraternal organizations provides, on page 517:

> "* * * Where dues are payable yearly in advance, and monthly income and expense statements are prepared, the proportionate amount of dues receivable for the month should be taken into income, and the unearned balance should be shown on the balance sheet as deferred income. * * *"

In the third edition (1943) of the Accountants Handbook, edited by W. A. Patton, the proper accounting method for revenue from services is stated, at page 114, as follows:

> "Advances by the customer or the client are perhaps more common in the case of services than in the case of sale of goods * * *. Collections on account of services to be furnished in subsequent periods should, of course, be excluded from current revenue."

The Commissioner's method imposes upon petitioner a hybrid system of accounting—strictly the cash receipts method with respect to membership dues and the accrual basis with respect to other items of income and to all of its deductions. In *Commissioner of Internal Revenue v. South Texas Lumber Co.*, (1948) 333 U. S. 496 at p. 501 this Court stated:

> "* * * a taxpayer generally cannot compute income taxes by reporting annual income on a cash basis and deductions on the accrual basis. Such a practice has been uniformly held inadmissible because it results in a distorted picture which makes a tax return fail truly to reflect net income."

Petitioner's method of accounting appeals to just plain common sense. In addition, it conforms to the generally accepted accounting practices applied in the case of prepaid dues. The Commissioner's hybrid method is condemned on both counts.

B. The Commissioner is unduly influenced by his desire to collect today a tax which in due course will be paid tomorrow.

Under petitioner's method of accounting, every single dollar of income was reflected in its books and, therefore, in its tax returns. The income from dues received in 1945, and earned in 1946, would not escape taxation under petitioners' method of accounting. Nevertheless, the Commissioner insists upon disrupting and ignoring petitioner's accounting system in order to tax for the year 1945 income which was earned in 1946 and reported in its 1946 return.

The Commissioner does not contend that the petitioner failed to apply its accounting method in a consistent manner from year to year. It is conceded that the petitioner did not adopt its accounting method for any tax reason. The method was adopted while petitioner was exempt from taxation and was not concerned with the filing of income tax returns.

On several occasions the lower courts have seen fit to criticize the Commissioner for refusing to accept an accounting system consistently employed by a taxpayer. In the case of *Pacific Grape Products Company v. Commissioner* (9th Cir., 1955) 219 F. 2d 862, the Ninth Circuit Court, in reversing a decision of the Tax Court which permitted the Commissioner to substitute his method of accounting for the method employed by the taxpayer, stated (page 869):

"Not only do we have here a system of accounting which for years has been adopted and carried into effect by substantially all members of a large industry, but the system is one which appeals to us as so much in line with plain common sense that we are at a loss to understand what could have prompted the Commissioner to disapprove it. * * *"[6]

In addition, the Court referred with approval to the dissenting opinion of six judges of the Tax Court, (17 T. C. 1097, 1110) written by Judge Opper, who made the following comment with respect to the very practice which the Commissioner has employed in petitioner's case:

"*The practice of disapproving consistent accounting systems of long standing seems to me to be exceeding all reasonable bounds.* See Heer-Andres Investment Co., 17 T. C. 786. Methods of keeping records do not spring in glittering perfection from some unchangeable natural law but are devised to aid business men in maintaining sometimes intricate accounts. If reasonably adapted to that use they should not be condemned for some abstruce legal reason, but only when they fail to reflect income. There is no persuasive indication that such a condition exists here. On the contrary, a whole industry apparently has adopted the method used by petitioner.

"It will not do to say that respondent should not have disturbed petitioner's accounting method, but that since he has done so, we are powerless to do otherwise. *As long as we continue to approve the imposition of theoretical criteria in so purely practical a field, respondent will go on attempting to*

[6] The explanation of the Commissioner's action probably lies in the fact that the disapproval of the taxpayer's accounting method resulted in an asserted tax deficiency.

*seize on such recurring fortuitous occasions to increase the revenue, even though he may actually accomplish the opposite. * * *."* (Emphasis supplied.)

Similarly, in *Huntington Securities Corporation v. Busey* (6th Cir., 1940), 112 F. 2d 368 the Commissioner sought to substitute its method of valuing inventories for the method employed by the taxpayer. In denying the Commissioner the right to make the substitution, the Court said:

> "The method used by appellant in valuing its inventories in our opinion clearly, but not accurately, reflected income, which is all that is required * * *. In our opinion the errors of the taxpayer did not bring into operation the wide discretion of the Commissioner to reject its method of valuing inventories which was approximately correct and to select one which was at variance with the taxpayer's consistent method."

If the number of members paying dues to petitioner had remained constant during all of the years in controversy, and if the amount of dues were neither increased nor decreased during that period, the petitioner's method of reporting income would have produced the same figure each year as the Commissioner's method. If the membership had been decreasing during that period, the petitioner's method of accounting would have shown a higher income than the method now urged by the Commissioner. No doubt, if petitioner's membership had been constant or decreasing during the period involved, the Commissioner would not have tried to substitute his method of accounting for the petitioner's method.

But in a year where the membership increases over the preceding year, or in a year when the dues are raised, the

Commissioner's cash method of accounting produces a larger (but unearned) income than petitioner's method. Since petitioner's membership did increase in every year from 1943 through 1947, except for the year 1947, we find the incentive and the motive for the Commissioner's action in casting aside petitioner's long-established method of accounting.[7]

Unnecessary harassment results from the Commissioner's practice of substituting his accounting method for the taxpayer's method whenever the Commissioner sees an opportunity to pick up a quick tax dollar. While a bird in the hand may be worth two in the bush to the man with a gun, that philosophy should not be the guiding spirit in administering a tax system which, far from being a "one-shot" affair, effects its toll from year to year. In the interest of decent tax administration—which should give some regard to avoiding harassment of taxpayers—the Commissioner should not be permitted to cast aside a long-established and consistently applied accounting method in the absence of a serious distortion of income. In petitioner's case there is a serious distortion of income only if the Commissioner's cash receipts method of accounting is substituted for the method which petitioner adopted—without regard to tax consequences—as best suited to its activities.

The Commissioner's rejection of petitioner's method of accounting violates the letter and spirit of his regulations (Sec. 29.41-3 of Regulations 111) which state:

---

[7] If it had not been for a raise in dues from $10 to $12 effective in October 1946, the petitioner's method of reporting income for the year 1947, when membership decreased by about 16,000 from the 1946 figure (R. 5), petitioner's method of accounting would have produced a greater income for 1947 than the Commissioner's cash method.

"It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose."

C. The Commissioner erred in applying the claim of right doctrine in petitioner's case.

(1) Decisions of this Court on claim of right.

The Commissioner's action in placing the petitioner on the cash basis with respect to membership dues was sustained by both the Tax Court (R. 144, 160) and the Sixth Circuit Court of Appeals (R. 190, 200). The Sixth Circuit stated that the determination of the Commissioner that membership dues should be included in income for the year in which they were received "was clearly correct", and cited three decisions of this Court as being in support of its conclusion. *North American Oil Consolidated v. Burnet,* (1932) 286 U. S. 417; *Security Flour Mills Company v. Commissioner of Internal Revenue* (1944) 321 U. S. 281; and *United States v. Lewis,* (1951) 340 U. S. 590.

The Sixth Circuit opinion made no reference whatever to the decision and opinion of the Tenth Circuit Court of Appeals in *Beacon Publishing Company v. Commissioner,* (10th Cir., 1955) 218 F. 2d 697, even though the latter opinion (upon which the petitioner strongly relied in the Circuit Court below) made it clear that the Commissioner's application of the claim of right doctrine is not supported by the decisions of this Court.[8]

---

[8] In its brief submitted to the Sixth Circuit, the respondent contended that the decision in the Beacon Publishing case was incorrect, but he did not file a petition with this court for a writ of certiorari.

The claim of right doctrine appears to have been first applied in a tax case by this Court in *North American Oil Consolidated v. Burnet, supra.* In that case the taxpayer in 1917 received money representing profits earned in 1916 from certain oil land. A dispute over title to the oil land was not settled until 1922. The taxpayer contended that the income was taxable either in 1916, the year it was earned, or in 1922 when the litigation was settled in its favor. This Court, in holding that income was taxable in the year received stated the "claim of right" doctrine as follows:

> "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return (for tax purposes) even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. * * *"

It is clear that the facts of this case are not applicable by analogy to petitioner's case. When petitioner received money for membership dues none of the money had been earned. In earning that money petitioner had to make expenditures in the year following receipt of the cash. But in the *North American Oil* case the money received in 1917 had already been earned. No expenses were incurred after the receipt of the money in earning that income.

The *North American Oil* decision was cited in *Brown v. Helvering* (1934) 291 U. S. 193, where the taxpayer was a general agent for insurance companies, and received commissions on policies whose terms extended beyond one year. If a policy was cancelled, Brown was required to refund a proportionate amount of the commission to the insurance company. Under his method of accounting, he treated the commissions as income when received, and

in the event a policy was cancelled, he deducted the refund as an expense in the year of refund. He sought to change that method of accounting so as to charge to expense in the year in which a commission was received an estimated reserve to recover refunds that would occur in the future. With respect to that contention this Court held that Brown was not entitled to take a current deduction for the refunds he might have to make in subsequent years.

Brown made an alternative contention before the Court —that the cash commission received should be taken up as gross income on a deferred basis, pro rata over the life of the policy. As to that, this Court made two pertinent observations. In the first place, the Court stated that Brown had never kept his books on that basis. In the second place, the Court said (291 U. S. 193, 204):

> "* * * Moreover, the Board concluded that there 'is no proof that the overriding commissions contain any element of compensation for services to be rendered in future years.' * * *."

The Brown case merely informs us, as did the *North American Oil* case, *supra,* that it is immaterial that the taxpayer may have to refund all or part of money he has received under a claim of right and without restriction on use. The case does not stand for the proposition urged by the Commissioner that it is immaterial, when cash is received before it is earned, that the expenses of earning the income will be incurred after the year of receipt of the cash. The *Brown* case was decided on the assumption that there were no services to be rendered after the money had been received.

In *Security Flour Mills Company v. Commissioner, supra,* the taxpayer added a processing tax, which it was

contesting, to the selling price of flour sold in 1935. In subsequent years the taxpayer refunded to its customers portions of the processing tax collected in 1935 but not remitted to the United States, and claimed a deduction should be allowed for the year 1935 instead of for the years of the refunds. This Court held that the deductions were not allowable for the year 1935 and that the entire selling price of the flour in 1935, including the added tax, was taken into account in computing income for the year of the sale. Here again, as in *Brown v. Helvering, supra*, the taxpayer did not, after the year of receipt of the income in question, deliver goods or perform services to earn that income.

The claim of right doctrine was applied by this Court in *United States v. Lewis, supra* and in *Healy v. Commissioner of Internal Revenue*, (1953) 345 U. S. 278. In the *Lewis* case, the taxpayer in 1944 received a bonus as compensation for services rendered, as an employee. In a subsequent year he was required to return a part of the bonus to his employer. In the *Healy* case, the taxpayer had received a salary from a closely held corporation in which he was an officer and stockholder. Subsequently, and after the corporation had been liquidated, the Commissioner disallowed the deduction by the corporation of part of the salary as being unreasonable compensation. Healy, as a transferee, had to pay the additional corporate tax attributable to the disallowance of the excessive salary payment, and he contended that the amount of the salary he received should be reduced, for tax purposes, by the amount of the corporate tax he paid. He also contended, unsuccessfully, that he received the salary under a restriction as to use.

In both the *Lewis* and *Healy* cases the compensation received by the taxpayers had been earned at the time of the

receipt. No services were rendered or expenses incurred after the compensation was received, without restriction on its use. This Court merely applied the rule previously announced in the *North American Oil* and *Brown* cases, that money already earned, and received without restriction as to use is taxable when received despite the fact that all or part of the money may have to be or was returned, for one reason or another, in a year subsequent to its receipt.

From the foregoing, it is quite apparent that the Commissioner, and the lower courts in this case, are in error in contending that the claim of right doctrine as applied by this Court requires that the prepaid membership dues received by petitioner, to the extent that they were earned in the year following their receipt, were nevertheless taxable when received. It is clear that this Court, without reversing or modifying any of its previous decisions, can sustain petitioner's contention that it is entitled to take prepaid membership dues into account for tax purposes in accordance with its long established method of accounting.

(2) The Beacon Publishing Company case.

The facts in *Beacon Publishing Company v. Commissioner,* (10th Cir., 1955) 218 F. 2d 697 are indistinguishable in principle from those in petitioner's case. The Tax Court (21 T. C. 610, 611) stated that the question was whether the amount of prepaid subscriptions received by a publishing company is taxable in the year of receipt, or whether the prepaid amount could be deferred for taxation over the period of the subscriptions. The Commissioner's position was that the claim of right doctrine applied, notwithstanding that the expenses of earning the prepaid income would be incurred following the year of receipt.

The Tax Court agreed. The Tenth Circuit Court of Appeals reversed.

In the *Beacon* case, the taxpayer received prepaid subscriptions for a period varying from thirty days to five years. All of the expense in earning the prepaid subscriptions was not incurred in one year, just as in petitioner's case all the expenses of earning membership dues was not incurred in one year. When a prepaid subscription was received, it was credited to an account entitled "Prepaid Subscriptions", just as the petitioner credited the receipt of dues to the account designated "Unearned Membership Dues."

The Tenth Circuit in the *Beacon* case noted that the Tax Court had applied the "claim of right" doctrine to support its decision, and that the Commissioner on brief had specifically stated that the "claim of right" doctrine was "the legal theory underlying the Tax Court's decision." The Circuit Court agreed that taxable funds received under a "claim of right" are returnable in the year of receipt. But it disagreed with the Commissioner's position that the "claim of right" doctrine applies to prepaid receipts where the taxpayer keeps his books on the accrual basis of accounting and the prepayments have to be earned in the future. The Court in rejecting the Commissioner's position stated (page 701):

> "* * * This would produce an incongruous result. It would permit the collection of taxes during periods not contemplated by the accrual method of accounting, and force the taxpayer into a cash receipts basis, for all prepaid items. *Such was not the reasoning or the purpose of the cases relied upon.* Such an application of the rule requires the taxpayer to report its prepaid income on a cash basis and to accrue its deductions. It creates a hybrid bookkeeping system and results in a tax

return which does not clearly reflect income. * * *."
(Emphasis supplied.)

The Tenth Circuit therefore, validly distinguished situations involving "claim of right" cases where there is a dispute as to ownership of taxable funds or, for other reasons, the contingency exists that part or all of such funds may have to be returned in a subsequent year, from cases involving prepaid income. As the Court observed, the *Beacon* case was not a situation where the Commissioner properly exercised his discretion to insist on an accounting method clearly reflecting income, but rather a case where the Commissioner improperly applied a legal principle.

In holding that the Tax Court was in error as to the tax treatment of prepaid income of the kind presented in petitioner's case, the Circuit Court stated (page 700):

> "It gave no consideration to the fact that the taxpayer accounts for its income under the accrual method and will not incur the expenses necessary to earn the income until the following taxable years. In other words, the Tax Court holds that advance payments received by a taxpayer, which are subject to income tax, must be returned in the year of receipt if owned or claimed by the taxpayer, regardless of the method of accounting which has been adopted, or when the funds are actually earned. Such application of the rule limits the accrual method to that class of cases where money has been earned and the right to it has been fixed, but the receipt is delayed to a subsequent taxable period. The application of the doctrine would in most cases result in a distortion of an accrual taxpayer's true income."

(3) Recent decisions which conform to the Beacon Publishing Company case.

The Fifth Circuit Court in *Schuessler, et al., v. Commissioner* (1956) 230 F. 2d 722, reached the same conclusion as the Tenth Circuit in the *Beacon Publishing Company* case in distinguishing and holding inapplicable the "claim of right" doctrine to the prepayment of income to be earned in subsequent years.

In the *Schuessler* case the taxpayer sold furnaces. Included in the sales price was the guarantee to turn on and off such furnaces for the next five years. The taxpayer reported the sales price in the year of receipt but deferred taxation on the full amount by setting up and deducting in the year of receipt a reserve for the estimated expenses to be incurred during the following five years. The Tax Court recognized that the case presented the same issue as in the *Beacon Publishing* case, for the reason that the taxpayer was attempting to defer, as income, the sales price which he received for the furnaces, to the years in which he was obligated to perform the services required by the sales contract. The Tax Court, in sustaining the Commissioner, applied the "claim of right" doctrine, stating (24 T. C. 247, 249):

> "* * * the *Beacon Publishing Company* case does not appear to us to conform to the firmly established 'claim of right' doctrine governing the receipt of income and its taxability in the year in which received."

The Fifth Circuit analyzed the petitioner's method of accounting and concluded that it came much closer to giving an accurate picture of his income than the method contended for by the Commissioner and stated (page 723):

"We find that not only does it [taxpayer's accounting method] not offend any statutory requirement, but, in fact, we think it is in accord with the language and intent of the law. Clearly what is sought by this statute is an accounting method that most accurately reflects the taxpayer's income on an annual accounting basis * * *.

"The case of *Beacon Publishing Co. v. Commissioner* is considered by both parties here and was noted by the Tax Court as of special significance. That case involved the treatment of prepaid income received by the *Beacon Publishing Co.* covering subscriptions to be furnished in subsequent years * * *.

"We prefer the reasoning as well as the conclusion reached by the Court in the Tenth Circuit. There the opinion correctly, we think, disposed of the 'claim of right' theory advanced by the Commissioner and adopted by the Tax Court in this type of case."

See also the decision of the Ninth Circuit in *Pacific Grape Products Company v. Commissioner* (1955) 219 F. 2d 862, (quoted from on page 29 of this brief) and the decision of the Sixth Circuit in *Henry Hilinski v. Commissioner* (1956) 237 F. 2d 703. In both cases the Circuit Courts, reversing the Tax Court, held that the Commissioner was in error in refusing to accept the taxpayer's treatment on its books of expenses to be incurred. In both cases the taxpayer's books were designed to bring into one accounting period the income and related expenses.

The Solicitor General did not authorize the filing of a petition for certiorari in the foregoing cases or in the *Beacon Publishing Company* case.

(4) *The Commissioner has been inconsistent with respect to his treatment of prepaid income.*

The Commissioner's treatment of prepaid dues in petitioner's case is contrary to his position in certain other areas which are indistinguishable in principle from prepaid dues. In *I. T. 3369,* 1940-1, C. B. 46, the Commissioner noted that two methods of accounting are followed by publishers of periodicals. Under the first method, the publisher reports all of the income from prepaid subscriptions in the year of receipt. Under the second method, the publisher reports only an aliquot part of the subscription price for each year of the subscription period. The Commissioner ruled:

> "It is held that where a publisher of periodicals has, over a period of years, followed consistently either of the two methods outlined above, he may continue to file his returns on such basis, he will not be required to change to the other basis, and his net income for the past years will not be redetermined on such other basis."

In *I. T. 2080,* III-2, C. B. 48, (1924) the taxpayer was engaged in the business of running various cruises and tours, the receipts for which were principally received in the last two months of the year, while the expenses were incurred in the following year. The Bureau ruled that in order for the taxpayer to show his taxable net income properly, he should file his income tax returns in accordance with the accrual method of accounting so that income received and the expenses incurred in earning it would be reflected in the same accounting period.

The Commissioner's treatment of bond premium is a striking example—in contrast to his position in petitioner's case—of permitting amounts received in one year (with-

out any restriction as to use) to be reported as income in years following the year of receipt. Sec. 29.22(a)-17 (2) (a) of Regulations 111 provides:

> "If, subsequent to February 28, 1913, bonds are issued by a corporation at a premium, the net amount of such premium is *gain or income which should be prorated or amortized over the life of the bonds* * * *." (Emphasis supplied.)

Also, with no statutory authority except for section 42(a) (discussed at page 26, *supra*), the Commissioner, by regulation (section 29.42-4, Regulations 111), has approved two methods of accounting for the profits derived from long term contracts, either of which will permit gross income to be reported as taxable income in a year *after* the year of receipt. If the "completed contract method of accounting" is adopted for reporting income derived from long term contracts, many payments received by the contractor are not included in gross income until *after* the year of receipt.

If it be true, as the Commissioner contends, that the "claim of right" doctrine prohibits proper accounting for prepaid dues income, it would appear that the Commissioner is also contending that his regulations with respect to bond premium, long term contracts, as well as *I. T. 3369, supra*, are invalid.

D. The Significance of the Repeal of Sections 452 and 462 of the Internal Revenue Code of 1954.

Sections 452 and 462 of the Internal Revenue Code of 1954 were intended to settle for 1954 and subsequent years the controversies which have arisen over the tax treatment of prepaid income and taxpayer's reserves for estimated expenses. Section 452, dealing with prepaid in-

come, specifically reached the same result which the Tenth Circuit reached in the *Beacon Publishing Company,* case, *supra,* and which the Sixth Circuit refused to reach in petitioner's case. But section 452 covered many types of prepaid income which present problems not involved in petitioner's case, and it can be noted that section 452 did not provide that the taxpayer could report prepaid income on a deferred basis only if he keeps his books in that manner. Section 462 specifically allowed a deduction for a reserve for estimated expenses of the type involved in the *Schuessler* case, *supra,* as well as in other situations.

In 1955 sections 452 and 462 of the Internal Revenue Code of 1954 were repealed (Public Law No. 74, 84th Cong. 1st Sess.). The Ways and Means Committee, in recommending the repeal, stated (H. Rep. No. 293, 84th Congr. 1st Sess., p. 4):

> "Your committee in repealing sections 452 and 462 does not intend to disturb prior law as it affected permissible accrual accounting provisions for tax purposes, including the treatment of prepaid newspaper subscriptions."

The Secretary of the Treasury advised the Chairman of the Committee on Ways and Means as follows (H. Rep. 293, *supra,* p. 295):

> "Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 Code. In other words, the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co. v. Commissioner,* (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions."

Similar statements were made by the Senate Finance Committee in its report on Public Law No. 74 (Senate Report 372, 84th Congress, first session, p. 5-6). It is, therefore, quite clear that so far as Congress is concerned, it has not discouraged a decision in petitioner's favor and certainly has not encouraged or in any manner approved the Commissioner's attempt to reject, for tax purposes, petitioner's method of accounting for prepaid membership dues.

II.

THE RETROACTIVE REVOCATION OF PETITIONER'S EXEMPTION WAS ARBITRARY AND BEYOND THE COMMISSIONER'S POWER

A. In General: The Nature of the Issue.

The regulations prescribed by the Commissioner have, for many years, required that an organization claiming a tax-exempt status must file an application for a ruling as to its tax-exempt status.[9] Article 101-1 of Regulations 94 (Appendix A, pp. 5a to 6a) in force during 1938 when the Commissioner ruled for the second time (R. 59) that petitioner was exempt from taxation, provided:

> "A corporation is not exempt merely because it is not organized and operated for profit. *In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the*

[9] Form 1025 (the affidavit for organizations claiming exemption) provides: "Unless the Commissioner has determined that an organization is exempt, it must prepare and file a complete income tax return for each taxable year of its existence, * * * As soon as practicable after the information and data are received, the organization will be advised of the Commissioner's determination, and, if it is held to be exempt, no further returns of income will be required" (R. 64, 65).

tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption * * *.

"The Collector, upon receipt of the affidavit and other papers, will forward them to the *Commissioner for decision as to whether the organization is exempt.*

"When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created." (Emphasis supplied.)

While the Commissioner has not published the number of rulings he has issued pursuant to the mandate of these regulations (and corresponding provisions of regulations applicable to other years), I. R. S. Publication No. 78 (a Cumulative List, revised to October 31, 1954) lists over 36,000 organizations which have been held by the Commissioner to be tax exempt organizations of the type to which contributions are deductible. No figures are available which would indicate the number of other organizations (labor or agricultural associations, fraternal societies, social clubs, business leagues, farmers cooperatives, etc.) which have received rulings from the Commissioner declaring they are exempt from taxation, but no doubt the number is very large.

Petitioner was one of the many thousands to whom the Commissioner, in accordance with the regulations, issued a ruling as to tax exempt status. In 1934, and again in 1938, the Commissioner of Internal Revenue—after "careful" consideration of the facts as to the organization of petitioner, its purposes, and manner of operation—ruled that petitioner was exempt from income taxation and was, therefore, not required to file income tax returns (Statement, *supra*, pages 7 to 11).

Neither the ruling of 1934 or 1938 was of general application, each was concerned only with the income tax status of petitioner.[10] Neither ruling was published in the Internal Revenue Bulletin.

In 1945 a successor Commissioner of Internal Revenue concluded that the prior rulings given to petitioner in 1934 and 1938 were erroneous. His conclusion that the prior rulings were erroneous was not based on any amendment to section 101(9) of the Internal Revenue Code of 1939 (or corresponding provisions of prior law), or upon any change in the regulations interpreting section 101(9).[11] The Commissioner did not claim that petitioner obtained its prior rulings by reason of any misrepresentation or concealment of the facts in any respect, and there was no contention that petitioner had failed to operate

---

[10] To use Judge Goodrich's characterization of this type of ruling in the recent case of the Lesavoy Foundation v. Commissioner of Internal Revenue, — F. 2d — (3rd Cir., decided November 21, 1956, 57-1 USTC Par. 9229) the rulings in petitioner's case were "individualized" rulings.

[11] In Keystone Automobile Club v. Commissioner, 181 F. 2d 402 (3d Cir. 1950) it was stated: "From the very beginning Treasury regulations have interpreted section 101(9) as applicable to social clubs and social clubs only."

in the manner contemplated when the rulings of exemption were issued in 1934 and 1938.

The reason for the determination that the prior rulings were erroneous was that the Commissioner in 1945 held a different view of the statute than did the Commissioner in 1934 and 1938. The position of the Commissioner in 1945 was that since fellowship between the petitioner's members did not play a material part in the life of the organization, the Commissioner, in 1934 and 1938, was wrong in determining that petitioner was exempt from taxation.

On July 16th, 1945, the Commissioner wrote a letter (R. 66, 67) to petitioner revoking the prior ruling letters dated June 11, 1934 and July 5, 1938. This revocation was not merely prospective. The Commissioner, without any further inquiry as to the facts and without giving petitioner an opportunity for a conference, ordered petitioner to file income and excess profits tax returns for two years then already passed—the years 1943 and 1944.

The Commissioner's position is clear. He contends that he has the power, whenever he determines that he (or his predecessor) has issued an erroneous ruling to a taxpayer, to revoke that ruling with complete retroactive effect. It does not matter, in the opinion of the Commissioner, that the only error in the case was committed by him or by his predecessor. As the Commissioner sees it, the only protection the taxpayer has (aside from the statute of limitations) is the Commissioner's own sense of fairness in determining the extent to which the revocation of the ruling should be without retroactive effect.[12]

---

[12] In the Lesavoy Foundation case, discussed infra at page 53, the Commissioner's sense of fairness permitted him to revoke a tax exempt ruling retroactively with the result that the Commissioner would have taken all of the assets of the Foundation. The Third Circuit Court came to the rescue.

The Commissioner draws no distinction between a ruling of tax exempt status—which a taxpayer is required to apply for under the regulations—and other types of rulings.[13]

After the Tax Court's decision was rendered in petitioner's case on September 23, 1953, the Commissioner announced his policy with respect to retroactivity in two separate rulings. Rev. Rul. 54-164, 1954-1 C. B. 88 (pertinent text is set forth in Appendix B, page 11a) dealt with tax exempt organizations; and Rev. Rul. 54-172, 1954-1 C. B. 394 (pertinent text is set forth in Appendix B, page 12a) dealt with other types of individualized rulings and with rulings published in the Internal Revenue Bulletin. A reading of these rulings reveals that under the Commissioner's view his power to revoke with retroactive effect a ruling of tax-exempt status issued to a particular organization is no less than his power to revoke retroactively a ruling published in the Internal Revenue Bulletin, which some taxpayer may have read and relied upon. A ruling issued on the unsolicited[14] request of a taxpayer

[13] The Commissioner apparently makes one exception. In Rev. Rul. 54-172, 1954-1 C. B. 394, page 401 he states:

".07 Under the provisions of section 1108(b) of the Revenue Act of 1926 (which is regarded as still in effect even though not incorporated in the Internal Revenue Code), a ruling holding that the sale or lease of a particular article is subject to the manufacturers' excise or the retailers' excise tax must be limited in its retroactive application in any case, where (1) such ruling reverses a prior ruling holding the particular article to be nontaxable, and (2) the taxpayer in reliance upon such ruling parted with possession or ownership of such article without passing the tax on to his customer."

[14] In James Couzens, 11 B. T. A. 1040 (1928) the taxpayer had asked for a ruling as to the valuation of Ford Motor stock as of March 1, 1913. In holding that the Commissioner was not bound by the ruling given, Judge Van Fossan, concurring, referred (p. 1174) to this type of ruling as one granted "as a courtesy" to the taxpayer.

as to the tax treatment of some item; is, apparently, in the eyes of the Commissioner, of equal dignity to a ruling of tax exemption. He treats them alike so far as his policy of retroactive revocation is concerned.

So far as petitioner's case is concerned, the Commissioner argues that petitioner was never, under the statute, exempt from income tax, and that the rulings issued to the contrary in 1934 and 1938 cannot create an exemption not provided by the statute. In such a case, the Commissioner contends that he is not limited to a correction of the erroneous rulings with prospective effect only, but that he has the power to act as if the rulings had never been issued. In petitioner's case, the Commissioner could have in 1945, under his view of the law, retroactively revoked the previous rulings without limitation.[15]

The Commissioner's position is based, fundamentally, on a belief that he is immune from all doctrines of estoppel, and that section 3791 (b) of the Internal Revenue Code of 1939 (Appendix A, p. 39) recognizes such immunity. While there are some court decisions which give direct support to the Commissioner's position,[16] the better cases (hereafter discussed) as to the contrary.

---

[15] Petitioner did not file returns for any of the years prior to 1943. Since the Commissioner contends in this case that the statute of limitations cannot start to run before a return is filed, the Commissioner, under his position, was restrained only by his sense of fairness.

[16] Quite clearly, decisions of this Court to the effect that the Government cannot be estopped by the unauthorized acts of its agents are not applicable here. See Utah Power & Light Co. v. U. S., 243 U. S. 389 (a non-tax case) and Merrill v. Federal Crop Insurance Corporation, 322 U. S. 380 (non-tax case). The Commissioner of Internal Revenue, in issuing rulings of tax exempt status of organizations, is not performing an unauthorized act.

In some instances the lower courts (assuming that the Commissioner was immune from estoppel) have applied the immunity doctrine reluctantly, and with misgivings. For example, in *Walker-Hill Co. v. U. S.*, (7th Cir. 1947) 162 F. 2d 259, the Commissioner refused to honor a previous ruling given to the taxpayer by the Alcohol Tax Unit. In holding that the Unit's letter did not constitute an estoppel against the Government, the court observed:

> "It never gives a satisfactory, reassuring feeling, however, for the Government to repudiate the act of one of its agents performed in the course of his duties. The rule against estoppel, however, is based upon the assumption that the Government's welfare, being of greater importance, outweighs individual injustices in particular cases."

In *Stockstrom v. Commissioner*, 190 F. 2d 283, (App. D. C., 1951), the Court found an estoppel against the Commissioner. While Circuit Judge Prettyman dissented from the holding of the majority, he commented as follows:

> "I wish the law were as they find it to be, because it is my belief that the Government ought to set a high standard in its dealings and relationships with citizens and that the word of a duly authorized Government agent, acting within the scope of his authority ought to be as good as a government bond."

In a most readable and scholarly article entitled "Estoppel Against the Government" (Raoul Berger, 21 Univ. of Chicago Law Review 680, 682 (1954)) the author states with respect to estoppel in tax cases:[17]

---

[17] The author concludes his article (at page 707) as follows: "Repudiation of representations is dirty business, no less at the hands of the government than of its citizens. Hence the claim of immunity for govern-

(Continued on following page)

"* * * There is also need to re-examine the rule that the government may repudiate an official interpretation by reliance on the 'mistake of law' doctrine, and to review the principles governing the right of an administrative officer to overrule the decision of a predecessor. * * * It may be added that the problem of governmental immunity from estoppel is most acute in the tax field because of (1) the great volume of tax cases, (2) the unduly cautious application of estoppel to the government in such cases, and (3) statutory ambiguities which complicate the estoppel-immunity problem in the tax field."

A decision on the issue presented in petitioner's case cannot settle all questions with respect to the Commissioner's power to apply his rulings retroactively.[18] But since retro-

---

(Continued from preceding page)

mental repudiation is tolerable only to the extent that it rests on inescapable compulsions arising out of the needs of government. * * * The claim of the government to an immunity from estoppel is in fact a claim to exemption from the requirements of morals and justice. As such, it needs to be jealously scrutinized at every step. Confidence in the fairness of the government cements our social institutions. No pinch-penny enrichment of the government can compensate for an impairment of that confidence, for the affront to morals and justice involved in the repudiation of a governmental representation."

[18] In a note, The Emerging Concept of Tax Estoppel, 40 Virginia Law Review 313, it was concluded:

> "The conclust must be that something is emerging in this area which may be called 'tax estoppel' for want of a better term. The development of this doctrine seems salutary. It is proper that the Commissianer's broad statutory authority should have imposed upon it some equitable limitations. The body of case law that is evolving is an answer to this need. It can be no surprise to any-

(Continued on following page)

active revocation of a ruling of tax exempt status is such an extreme case, a decision in favor of retroactive action by the Commissioner would be a step backward in the current endeavors to instill public faith and confidence in the Internal Revenue Service. "A victory may have implications which in future cases will cost the Treasury more than a defeat.'"[19]

Since our income tax system rests to a great and unique extent on voluntary compliance by the taxpayer in the self-assessment of the tax, it is extremely important that the taxpayer understands that he will be dealt with fairly by the government.[20] If the taxpayer knows that the Commissioner can and will violate basic rules of fairness in administering the tax law, the continued success of the system of voluntary self-assessment is placed in jeopardy. Certainly if the courts inform the taxpayer that the Commissioner need not turn square corners in dealing with him,

---

(Continued from preceding page)

one in the profession that, where the equities of the taxpayer are placed against the authority of the sovereign in so vital an area as taxation, the law is emerging case by case. No case, unless its facts be almost entirely duplicated in a later situation, can be of much authority.

"The process is slow, hesitant, and defies logical organization or codification. It is evident, however, that equitable limitations against the Commissioner are developing, and the result is to be welcomed by all who would place justice above revenue."

[19] Mr. Justice Jackson, dissenting, in Arrowsmith v. Commissioner, 344 U. S. 6, (1952).

[20] Mr. Daniel Webster observed that our government should take care in every part of the system "not only to do right, but to satisfy the community that right is done." 5 Writings and Speeches of Daniel Webster 163, quoted by Mr. Justice Frankfurter, concurring, in Joint Anti-Fascist Comm. v. McGrath, 341 U. S. 123, 172 n. 19 (1951).

it may be too much to expect the taxpayer to turn square corners when he deals with the Commissioner.[21]

B. Authorities in Support of Petitioner's Position.

In the case of *Lesavoy Foundation v. Commissioner*, ... F. (2d) ... (3d Cir. 1956, 57-1 U. S. T. C. 9229), the Commissioner in 1945 issued a ruling to the foundation that it was exempt from taxation under section 101(6) of the Internal Revenue Code of 1939. In 1951 the Commissioner revoked the ruling retroactively to the year 1946, during which year the foundation had acquired a mill which manufactured cotton yarn and cloth. The Commissioner claimed that the foundation in 1946 departed from its exempt purposes and was used in part as a means of furthering business enterprises of the donor of the foundation. The Tax Court sustained the deficiency asserted by the Commissioner.

The Third Circuit in reversing the Tax Court did not decide the question as to whether the revocation of the tax exempt ruling was correct insofar as prospective applica-

---

[21] "Mr. Justice Holmes made the often quoted statement that 'Men must turn square corners when they deal with the Government'; but, subsequently, referring to this observation, Judge McDermott, of the Tenth Circuit, in Howbert v. Penrose, 38 F. 2d, 577, 581, added that 'government ought to turn square corners when dealing with its citizens'." From the dissenting opinion of Judge McAllister in the case below (R. 200, 205).

In Menges v. Dentler (1859) 33 Pa. 495, 500, the Court said: "Men naturally trust in their government, and ought to do so, and they ought not to suffer for it * * * Indeed, it is an essential principle of government; for, if the right to trust to the highest governmental functionaries is denied, and such trust is unprotected, every man is bound to question every act of government that affects him, and to resist whatever he does not approve—a doctrine that would make government impossible."

tion was concerned. On that point Judge Goodrich stated for the Court:

> "The reason we do not need to go into the questions just stated is that we think the Commissioner went beyond his authority in revoking the certificate of exemption retroactively. We quite realize that the Commissioner may change his mind when he believes he has made a mistake in a matter of fact or law. Our own decision in *Keystone Automobile Club v. Commissioner*, 181 F. 2d 402 (3d Cir. 1950) recognizes this point fully and that point is sustained by abundant authority. But it is quite a different matter to say that having once changed his mind the Commissioner may arbitrarily and without limit have the effect of that change go back over previous years during which the taxpayer operated under the previous ruling."

Judge Goodrich then stated that there is a "dearth of cases" involving retroactive revocation of individualized taxpayers' rulings, and went on to say:

> "This is so because the Commissioner has almost invariably followed a policy of honoring his rulings and making changes prospective only, since the much criticized case of *James Couzens*, 11 B. T. A. 1040 (1928) (Contra, *Woodworth v. Kales*, 26 F. 2d 178 (6th Cir. 1928). Indeed, this policy has been codified by one of the Commissioner's own rulings:
>
> "The few authorities that there are concerning individualized rulings are not unanimous. The point has had the most attention in the Sixth Circut. The latest decision of that Court in *Automobile Club of Michigan v. Commissioner*, 230 F. 2d 585 (6th Cir. 1956), cert. granted, 25 U. S. L. Week 3095 (U. S. Oct. 8, 1956) (No. 89), discusses previous rulings and comes out with elaborate opinions both supporting and against the Commissioner's action" (Footnotes omitted.)

After reference to the holding of the majority opinion of the Sixth Circuit in petitioner's case, Judge Goodrich stated that "*on the other hand*" there is respectable authority that the Commissioner may not retroactively revoke an individualized taxpayer's ruling, and cited two earlier decisions of the Sixth Circuit, *H. S. D. Company v. Kavanagh*, 191 F. 2d 831 (1951) and *Woodworth v. Kales*, 26 F. 2d 178 (1928). Inasmuch as the Sixth Circuit had also decided petitioner's case, he stated that the Sixth Circuit attempted, in petitioner's case, to distinguish it from the *H. S. D.* and *Woodworth* cases, "but we find the distinction doubtful".

In its opinion the Third Circuit expressed the view that section 3791(b) of the Internal Revenue Code of 1939 (discussed later in this argument) "gives the Commissioner discretionary power to determine the extent of the retroactivity in a given case". But the Court then concluded that the Commissioner had gone "beyond the bounds of permissible discretion" in the retroactive revocation of the foundation's tax exempt status. The Commissioner had applied his revocation retroactively for five years. There was no suggestion however, that a lesser amount of retroactivity would have been sanctioned by the Court.

In its brief to the Sixth Circuit petitioner relied on the prior decisions of that court in the cases of *H. S. D. Company v. Kavanagh, supra,* and *Woodworth v. Kales, supra.* In the *Kales* case the taxpayer, before making a sale of Ford Motor Company stock, obtained a ruling from the Commissioner as to the fair market value of the stock as of March 1, 1913. After the taxpayer filed a return reporting gain on the sale, the Commissioner assessed an additional tax on the basis of a lower valuation which he had placed on the value of the Ford stock. The Sixth Circuit held that the second Commissioner was without authority to revoke

the determination of the former Commissioner. A contrary conclusion, on the same set of facts involving another taxpayer, had been reached by the Board of Tax Appeals in the case of *James Couzens*, 11 B. T. A. 1040 (1928).[22]

The *H. S. D. Company* case involved the retroactive revocation of a tax exempt ruling. The taxpayer had received a ruling from the Commissioner in 1944, and again in 1946, that two employees' trusts created by the taxpayer were exempt from taxation under section 165 of the Internal Revenue Code of 1939. In 1948 a successor Commissioner revoked the prior rulings retroactively to the date of the creation of the trusts. The first Commissioner had determined that the terms of the trusts did not discriminate in favor of highly compensated employees. The second Commissioner did not agree with the conclusion of his predecessor. The Sixth Circuit held that the second Commissioner was estopped and bound by the prior decision relied upon by the taxpayer, whether or not the prior decision was correct.

The *H. S. D. Company*, in establishing the tax-exempt status of the trusts, had submitted to the first Commissioner the information called for by regulations promulgated under section 165 of the Internal Revenue Code of 1939, just as the petitioner in establishing its own tax exempt status submitted the information called for by the regulations under section 101. The Sixth Circuit, in its decision in the *H. S. D. Company* case, attached particular significance to this aspect of the first ruling, stating (191 F. 2d 831, 846):

[22] In an article by J. P. Wenchell, "Taxpayers' Rulings" 5 Tax L. Rev. 105, 112, the author, a former Chief Counsel of the Bureau of Internal Revenue, stated that the Commissioner's action in the Couzens case "did little to instill public faith and confidence in the Bureau."

"Under the foregoing circumstances, and especially because of the fact that the Commissioner was given the unusual power by Congress to approve the plan and trusts and did so at various times during the course of the years, with full knowledge of all details relating to them and their operations, we are of the opinion that the Commissioner, in this case, was bound by the prior decisions of his predecessor that the plan complied with Section 165(a) of the Internal Revenue Code, as amended, and that the trusts were exempt."

The Commissioner, in determining in 1934 and 1938 that that petitioner was exempt from taxation, was performing precisely the same function he performed in determining that the trusts in the *H. S. D. Company* case were exempt from taxation. In both cases he made an administrative adjudication—he did not purport to render merely an advisory opinion.

The ruling letter of June 11, 1934 (R. 48) did not state that it was the current opinion of the Commissioner, subject to retroactive change, that petitioner was tax-exempt. The letter stated "It is held that you are entitled to exemption", and the letter referred to "The exemption granted in this letter." The lack in the letter of any suggestion or warning that the Commissioner might change his mind and revoke with retroactive effect is in striking contrast to the cautionary notice appearing on the front page of the Internal Revenue Bulletin for 1934, which states with respect to rulings published in the Bulletin:

> "The rulings reported in the Internal Revenue Bulletin are for the information of taxpayers and their counsel as *showing the trend of official opinion* in the administration of the Bureau of Internal Revenue." (Emphasis supplied.)

In writing the majority opinion for the court below Judge Allen attempted a distinction—which Judge Goodrich found was doubtful—between petitioner's case and the *H. S. D. Company* case. She stated (R. 190, 195) that the *H. S. D. Company* case involved no mistake of law but only different inferences from the same facts, and that "The Commissioner is not bound by his own or his predecessor's prior mistakes of law," but noted that in the *Kales* case the court declared that the Commissioner's "mistake of law will often, *or usually*, justify a revision of his conclusion." (Emphasis supplied.)

It is not necessary for petitioner to quarrel with the proposition, if it is stated as a general rule, that the Commissioner is not bound by his predecessor's mistakes.[33] Petitioner's case qualifies as a most proper exception to any such general rule. As Judge McAllister pointed out in his dissenting opinion, the Commissioner in 1934 and 1938, in ruling that petitioner was exempt from tax, did not make a mistake which was plainly erroneous or in conflict with express statutory provisions.

The first court decision as to the tax status of automobile clubs like petitioner was rendered on February 26, 1948 (more than two years after the Commissioner revoked pe-

[33] There is no question, of course, as to the right and propriety of correcting errors prospectively. But in the case of retroactivity, it is difficult to draw, insofar as equity is concerned, a distinction between a mistake of law and a mistake of judgment. If the Commissioner renders a ruling to a taxpayer, the Commissioner is bound by that ruling, under Judge Allen's view in opinion below, if the Commissioner correctly understood the law and correctly understood the facts, but make a mistake in putting the two together. But the Commissioner is not bound, according to Judge Allen, if he correctly understood the facts but made a mistake in the process of putting the law and facts together because of an erroneous interpretation of the statute. The distinction seems to be only one of words. In either case, the error was made by the Commissioner, and not by the taxpayer.

titioners' exemption) in the case of *California State Automobile Ass'n v. Smyth*, 77 Fed. Sup. 131 (Calif. D. C.). In this decision Judge Lemmon, now a member of the Court of Appeals of the Ninth Circuit, held that the automobile association was a club within the meaning of the statute. His decision, however, was reversed by the Ninth Circuit, *Smyth v. California State Automobile Association*, 175 F. 2d 752 (1949). When the same question was presented to the Tax Court in *Chattanooga Automobile Club v. Commissioner*, 12 T. C. 967, decided June 8, 1949, four members of that court were of the opinion that automobile clubs were exempt from taxation under section 101(9) of the Internal Revenue Code of 1939.

The Commissioner, of course, cannot contend that the meaning of the term "club" as used in section 101(9) was crystal clear. While he finally concluded that the term as used in the statute "contemplates commingling of members, one with the other in fellowship" (R. 67), he did not get that concept from a simple reading of a statute. His predecessor was unable to find that concept in the statute when he issued rulings in 1934 and 1938 to petitioner that it was exempt from taxation.

Against this picture Judge McAllister in his dissenting opinion stated (Record 200, 208):

> "That the prior rulings of the other Commissioners were based on a mistake of law, and, consequently, that the rulings can be revoked with retroactive effect, is the keystone of the Commissioner's argument in this case.
>
> "While the forego ng may be said to constitute the general rule, it is not every ruling based upon a mistake of law that may be afterward subject to so-called correction by the Commissioner, with retroactive effect. Where the construction of a statute by a former Commissioner has not been plainly er-

roneous, or in conflict with express statutory provision, a succeeding Commissioner may not revoke the former ruling with retroactive effect."

We submit that Judge McAllister was right.

The exemption letter of June 11, 1934 (R. 49) advised petitioner that it would not be required to file income tax returns "so long as there is no change in your organization, your purposes or methods of doing business." The exemption letter of July 5, 1938 (R. 59) stated: "the previous ruling of the Bureau holding you to be exempt from filing returns of income is affirmed." The revocation letter of July 16, 1945 (R. 67), in requiring the petitioner to file returns for 1943 and 1944, was a repudiation not only of the previous rulings as to the filing of returns, but it was a repudiation of the Commissioner's regulations. The regulations in effect on March 15, 1944, the due date for filing a return for the calendar year 1943 provided:

> "When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, *unless it changes the character of its organization or operations or the purpose for which it was originally created* * * *." (Emphasis supplied.) Section 29.101-1 of Regulations 111, prior to amendment by T. D. 5381, 1944 C. B. 188.[24]

[24] On June 26, 1944, T. D. 5381 amended the regulations under section 101 to conform them to the provisions of section 54(f), (added to the Code by the Revenue Act of 1943), relating to the filing of returns by tax-exempt organizations on Form 990. The amended regulations, applicable to taxable years beginning after 1942, continued to instruct the petitioner that it need not file a return of its income (other than the return on Form 990) for its years 1943 and 1944, by stating: "An organization which has established its right to exemption from tax under section 101, including an organization which is relieved under section 54(f) and these regulations from filing returns of income or annual returns of information, is not, however, relieved from the duty of filing other returns of information (see section 147 and 148)."

The regulations advising an organization that it need not file income tax returns after it has established its right to exemption are of long standing. They so provided in 1934 when the petitioner first established its right to exemption from taxation. Reg. 86, Art. 101-1. (Appendix A, page 4a.) These regulations, of course, were designed for the benefit and protection of the taxpayer and not for his entrapment. During a succession of revenue acts, Congress ratified and approved the regulations by its reenactment of the provisions of section 101 of the Internal Revenue Code of 1939. *Helvering v. R. J. Reynolds Tobacco Co.,* (1939) 306 U. S. 110.

The attempt in 1945 by the Commissioner to revoke with retroactive effect petitioner's exemption from filing returns was an attempt to deny petitioner the benefit of the regulations in force during 1943 and 1944. It is submitted that this attempt was a violation of a principle enunciated by this Court in the *Reynolds Tobacco* decision.

C. The Commissioner's Reliance on Section 3791(b).

Section 3791(b) of the Internal Revenue Code of 1939 provides as follows:

> "Retroactivity of Regulations or Rulings.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulations, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

The Commissioner contends that this section makes it clear that in 1945 he had the power, if he wished to exercise it, to revoke retroactively the previous rulings issued to petitioner without restriction or limitation. He made a similar contention to this Court in the case of *Helvering v. R. J. Reynolds Tobacco Co., supra.*

In the *Reynolds Tobacco* case, the taxpayer in 1929 sold treasury stock at a gain. The regulations then provided that a corporation realizes no gain or loss from the sale of its own stock. In 1934 the Commissioner amended his regulations to provide that taxable gain can be realized on the sale of treasury stock where the corporation deals in its own stock as it might in the shares of another company, and the Commissioner made the amended regulations effective retroactively to the year 1929. The Commissioner contended that section 3791(b) (then section 605 of the Revenue Act of 1928) specifically authorized such retroactive application. This Court disagreed and held, in effect, that there is no need to look at section 3791(b) until it is first determined that the Commissioner is confronted with a case in which retroactivity is permitted. This Court denied retroactive application of the amended regulations involved in the *Reynolds* case because of the reenactment by Congress, without change, of the definition of "gross income" while the old regulations were outstanding.

In this connection it is important to note that the Commissioner in 1934 did have the power to amend the regulations with prospective effect, although he did not have the right to do so retroactively. In *Dow Chemical v. Kavanagh* (6th Cir. 1943) 139 F. 2d 42, the taxpayer in 1936 (after the amendment in 1934 of the regulations involved in the *Reynolds Tobacco* case) sold treasury stock at a gain. The taxpayer contended that the regulations were invalid, but the Sixth Circuit held that the amended regulations were valid when applied with prospective effect only. The Court said:

> "It will be noted that there is here no question of giving retroactive application to the amended regulation so as to make taxable transactions which were not taxable before it was promulgated, as was the case in *Helvering v. R. J. Reynolds.* * * * If, however, there is an implication in the argument used in

the *Reynolds* case that an amended regulation is to be considered effective only after Congress has reenacted the provision sought to be interpreted, without change, the inference is definitely destroyed by the more recent cases of *Helvering v. Wilshire Oil Co.*, 308 U. S. 90 and *Helvering v. Reynolds*, 313 U. S. 428."

In *United States v. Anderson, Clayton & Co.* (1955), 350 U. S. 55, the Commissioner's 1934 regulations on gain from a sale (made in 1944) of treasury stock was again before this Court. The Court, at page 59, stated the question as follows: "Thus, whether the transaction here in question is taxable depends, in the final analysis, on whether respondent corporation dealt with its shares of treasury stock 'as it might' have dealt with another corporation's stock." No suggestion was made by the Court that the application, with prospective effect, of the amended regulations adopted in 1934 was invalid by reason of its prior decision in the *Reynolds Tobacco* case, *supra*.

We learn from the foregoing cases that although the Commissioner in 1934 had the right to amend his regulations with prospective effect, it did not follow from section 3791(b) that he therefore had the right to make the amendment applicable with retroactive effect. The Commissioner's rule-making power, insofar as prospective application is concerned, is not a measure or indication of his rule-making power with retroactive application.[25]

[25] "It [legislative approval] does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers. * * *

"These considerations are persuasive here not only in reaffirming the conclusion that the rule-making power existed, but also in concluding that restrictions on that power should not be lightly imposed where the incidence of such rules as are promulgated is prospective only." (Emphasis supplied.) Helvering v. Wilshire Oil Co. (1939) 308 U. S. 90, 100, 103.

Dean Griswold, in his article "A Summary of the Regulations Problem", *54 Harv. Law Rev.* 398, points out that the Commissioner should be *held* to have no power to make retroactive amendments of interpretive regulations, against the interests of taxpayers, in any case where the regulation has become seasoned, without regard to the reenactment rule. Insofar as section 3791(b) might be viewed as an obstacle to getting the right result, he observed at page 412:

> "The legislative history of this is interesting and mildly illuminating in showing the Treasury's struggle to get away from the judicial-decision theory of interpretive regulations. See *Seidman, Legislative History of Federal Income Tax Laws* (1938) 886-88, 563-64, 408-409. This statute did not greatly hinder the Court in *Helvering v. R. J. Reynolds Tobacco Co.*, 306 U. S. 110, 116 (1939), and it would seem that similarly it should not be a serious obstacle to the treatment of retroactive changes proposed here."

Section 3791(b) should be interpreted and applied in accordance with the purpose which Congress had in enacting the original provision. The legislative history referred to by Dean Griswold makes it perfectly apparent that the purpose was to *prevent* retroactivity—not to codify or confirm any right in the Commissioner to take retroactive action. The report of the Conference Committee (70th Cong. 1st Sess., H. Rept. 1882) on the Revenue Act of 1928 stated (at page 22):

> "It is hoped that this provision [the predecessor provision of section 3791(b)] will *prevent* the constant reopening of cases on account of changes in regulations or Treasury decisions, and it is believed that sound administration properly places upon the Government the responsibility and *burden of interpreting the law* and of prescribing regulations upon which the *taxpayers may rely* * * *." (Emphasis supplied.)

Petitioner need not—and does not—contend that the Commissioner can never revoke an individualized ruling with retroactive effect. To state an easy case, even where a ruling of tax exemption is involved, petitioner readily concedes that if such a ruling is based on a misrepresentation of facts by the taxpayer, the Commissioner has the power to revoke with retroactive effect[28] But if the misrepresentation was not willful, the Commissioner should have—and does have under section 3791(b)—the right to temper the amount of retroactivity.

But it is quite another matter to hold that the Commissioner also has power under section 3791(b) to revoke, with retroactive effect, a prior determination of the kind presented in petitioner's case. When a taxpayer, under the mandate of the Commissioner's regulations under section 101, submits in good faith, without reservation or misrepresentation of any fact or circumstance, all the information requested by the regulations, and the Commissioner makes an administrative adjudication that the taxpayer is exempt from taxation and from filing income tax returns, and thereafter the organization operates without change in the manner contemplated by the Commissioner, the Commissioner should be held not to have power to re-

[28] Southern Maryland Agricultural Fair Association (1939) 40 B. T. A. 549, was a case in which the taxpayer misrepresented the facts on which the Commissioner made his ruling of tax exemption, and the retroactive revocation of the ruling was upheld. The Tax Court, in petitioner's case below, rested its decision (R. 144, 153) on the Southern Maryland case in holding that the Commissioner had the right to revoke retroactively petitioner's tax-exempt status.

voke his determination with retroactive effect.[27] This should be the result whether the erroneous ruling originally granted was due to the Commissioner's misinterpretation of the statute or to an error in passing judgment as to the effect of undisputed facts and law.

Petitioner's case is even stronger than the proposition stated in the preceding paragraph. Petitioner's rulings of tax exemption had been outstanding for a long period of years; and it cannot be said that any misinterpretation of section 101(9), by the Commissioner granting the rulings, was plainly erroneous or in conflict with the express provisions of the statute.

The correct result in petitioner's case can be reached by a slightly different approach. Instead of stating that section 3791(b) was inapplicable in petitioner's case, it need merely be stated that any attempt to make the revocation of the rulings applicable to years prior to the year in which the revocation was made was, under the facts of

---

[27] In R. H. Stearns Co. v. United States (1934) 291 U. S. 54, Mr. Justice Cardozo observed (at pp. 61-62):

> The applicable principle is fundamental and unquestioned. "He who prevents a thing from being done may not avail himself of the nonperformance which he has himself occasioned, for the law says to him, in effect: 'This is your own act, and therefore you are not damnified' " * * * Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be permitted to found any claim upon its own inequity or take advantage of his own wrong. * * * A suit may not be built on an omission induced by him who sues. * * *

petitioner's case, arbitrary and an abuse of discretion.[28] Petitioner has conceded that the revocation on July 16, 1945, of its tax-exempt status, applied to the entire calendar year 1945. To that extent, the revocation was applied retroactively for a period of about six and one-half months, but petitioner would not claim—if section 3791(b) were applicable— that it was arbitrary and an abuse of discretion to make the 1945 ruling applicable to the taxable year in which received. But petitioner would contend and insist, if section 3791(b) were applicable, that under the facts of petitioner's case the Commissioner was arbitrary and abused his discretion under section 3791(b) in making the 1945 ruling effective to any taxable year already passed.

Congress has made it clear that it believes it is wrong to revoke a tax exemption with retroactive effect, except where the organization has been guilty of gross misconduct. When Congress dealt with the problem, it provided that if the Commissioner notifies an organization that it has lost its exemption by reason of engaging in prohibited transactions, the loss of exemption will apply only for taxable years *subsequent* to the year in which the Commissioner gives such notice. Section 3813 of the Internal Revenue Code of 1939 (now section 504 of the 1954 Code) was added to the 1939 Code by section 331 of the Revenue Act of 1950. Congress then provided that certain organizations exempt from taxation under section 101(6) of the 1939 Code would lose their exemption on engaging in certain pro-

[28] This was the approach used by Judge Goodrich in the Lesavoy Foundation case, supra, in holding that the retroactive revocation of tax exemption was invalid. But Judge McAllister, dissenting below, in holding that the retroactive revocation in petitioner's case was invalid stated that section 3791(b) "would not seem to apply when the Commissioner does not have the power to make a retroactive ruling" (R. 217).

hibited transactions. But as to the effective date of the loss of tax exemption, section 3813(c)(2) provides:

> "(2) Taxable years affected.—An organization shall be denied exemption from taxation under section 101(6) by reason of paragraph (1) *only for taxable years subsequent to the taxable year during which it is notified by the Secretary that it has engaged in a prohibited transaction,* unless such organization entered into such prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization." (Emphasis supplied.)

Retroactivity is not favored in the law.[29] When we compare the policy contained in section 3813 against retroactive loss of a tax exemption (even when the taxpayer is at fault) with the action taken by the Commissioner in petitioner's case (where a Commissioner, and not the petitioner, miscued), it is quite obvious that it is not safe to rely on the Commissioner's sense of fairness with respect to retroactivity. Unfortunately, court-imposed restraints have become necessary.

D. Reliance by Petitioner on the Rulings of Tax Exemption.

In the majority opinion for the Court below, Judge Allen stated (R. 190, 194): "As to the question of estoppel, petitioner does not assert that it has altered its position to its detriment in reliance on the former rulings of Com-

[29] "Retroactivity, even when permissible, is not favored, except upon the clearest mandate. It is the normal and usual function of legislation to discriminate between closed transactions and future ones. * * *" (Emphasis added.) Claridge Apts. v. Commissioner of Internal Revenue, 323 U. S. 141, 164.

missioner."[30] In its brief to the Court below, petitioner made the following assertions:

> "The petitioner relied in good faith on the rulings made by the Commissioner in 1934 and 1938 holding it exempt from taxation. In keeping with the instructions received in the ruling letters, petitioner did not file income tax returns, since no change had occurred in the organization of the club, its purposes, or activities. Petitioner, in faithful reliance on the tax-exempt rulings, did not during 1943 and 1944 set up any reserve, or make any other provision, to cover the income and excess profits taxes later asserted by the Commssioner for those years. The club was operated during 1943 and 1944 in all respects on the premise that it was exempt from taxation. As a result of the retroactive application of his 1945 ruling, the Commissioner asserted a deficiency in income and excess profits taxes for the years 1943 and 1944 in the amount of $384,059.97."

Judge McAllister, in his dissenting opinion below, had no difficulty in finding that petitioner had relied on the rulings to its detriment (R. 218).

The Commissioner contends in this case that even though a taxpayer has a ruling stating that he is exempt from tax and from filing income tax returns, the statute of limita-

[30] In a Note, 56 Columbia Law Review 1115, commenting on the majority opinion below, it was stated (at page 1118): "It seems rather evident that the Commissioner's prior rulings did in fact induce reliance by the taxpayer to its detriment, in that no provision was made to attempt to meet the tax assessment, nor was a return filed to start the running of the statute of limitations. * * * Although taxpayers might protect themselves to some extent by filing returns whether an exemption is granted or not, it would seem that when taxpayers reasonably rely on rulings specially made for their own given set of circumstances, it is not out of order to prevent the Government, either by legislative provision or court-imposed estoppel, from subsequently upsetting these justifiable expectations."

tions can nevertheless not commence to run until a return is filed. If the Commissioner is correct in that contention, then it is hardly necessary to comment further. Certainly reliance on a ruling at the expense of losing the protection of the statute of limitations constitutes reliance with unmistakable detriment.

The petitioner kept its books and managed its affairs on the assumption that it was exempt from taxation. One of the officers of petitioner testified (R. 138): "We weren't taxable. We didn't have that problem to consider." Certainly it is a matter of common knowledge, requiring no additional support in the record, that a taxable organization cannot intelligently engage in business from day to day without taking into account the tax consequences of contemplated transactions. This was particularly true during 1943 and 1944 when the excess profits tax rate of 90% was applicable. (A part of the asserted deficiencies for 1943 and 1944 was attributable to the excess profits tax.) Prior to the revocation of its tax exemption, petitioner conducted its affairs as if income and excess profits taxes did not exist. Moreover, if it had anticipated prior to 1945 that it would be subjected to taxation for prior periods, reserves for such taxes would have been established.

It is not an answer to assert that a taxpayer does not suffer a detriment if he is unexpectedly called upon to pay taxes which were imposed on him but which he believed, by reason of a tax-exempt ruling, were not payable by him. The detriment would be ridiculously obvious if the petitioner in 1945 had been called upon to pay taxes for all years from 1916 to 1945. No doubt its assets would have been insufficient. Any lesser amount of retroactivity merely reduces, but does not eliminate, the degree of detriment. In the *Lesavoy Foundation* case, *supra*, there was no dispute as to the amount of taxes imposed for the

prior years if the Commissioner had the right to revoke retroactively the tax exemption. There was no element of reliance with detriment in the *Lesavoy* case which is not present in petitioner's case.

E. Petitioner Did Not Receive Notice of Revocation Before July 16, 1945.

The Commissioner has contended that its revocation of petitioner's tax exemption was really not a retroactive revocation in light of the publication in the Internal Revenue Bulletin of *G. C. M. 23688,* 1943 C. B. 283. Neither the Tax Court nor the Circuit Court of Appeals adopted the Commissioner's position on that score. Both courts rested their decisions on the ground that the Commissioner had the power in 1945 to revoke retroactively the prior rulings. Judge McAllister, in his dissenting opinion below, specifically held (R. 216):

> "The taxpayer did not have notice as claimed herein by the Commissioner, during 1943 and 1944, of the pending revocation of its exemption rulings."

He pointed out that the G. C. M. concerned the American Automobile Association, an organization consisting of other incorporated clubs and having rules against membership of any individuals. On this point, it is pertinent to note the characterization given to *G. C. M. 23688* in the opinions in *Chattanooga Automobile Club,* 12 T. C. 967 (1949). The majority opinion, by Judge Murdock, held that the automobile club was taxable because it was rendering services of a commercial nature to members. He made no mention of *G. C. M. 23688.* In a dissenting opinion, Judge Harlan stated (p. 972):

> "Recently, however, General Counsel Memorandum 23688, 1943 C. B. 283, was promulgated, and

therein the General Counsel ruled differently concerning *an automobile 'association'*. The proceeding at bar is an attempt to support this memorandum on *the apparent assumption* that it applies to *local automobile 'clubs'*." (Emphasis supplied.)

Judge LeMire, in a separate dissenting opinion, stated with respect to the G. C. M. (at p. 973):

> "* * * It was not until 1943 that he reversed his position, ruling in G.C.M. 23688, 1943 C. B. 283, *that an association functioning as a federaton of automobile clubs* was not a club within the meaning of section 101(9), Internal Revenue Code, and was not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes within the meaning of that section." (Emphasis supplied.)

Most important is the fact that the Commissioner himself did not, until this case reached litigation, consider that petitioner had received notice in 1943 of the revocation of its tax exempt status. The letter which the Commissioner sent to petitioner on May 12, 1945 (R. 59, 60) stated that the "Bureau is now reconsidering" the question of the exemption of automobile associations in the light of the opinion of the Chief Counsel as set forth in G. C. M. 23688. Furthermore, the Commissioner did not claim or assert in this proceeding that the petitioner was subject to any penalty for failure to file the returns for the years 1943 and 1944 within the time prescribed by law. The failure to assert any penalty is, of course, consistent with the simple fact that the Commissioner himself did not consider the publication of G. C. M. 23688 as notice to the petitioner that its tax exempt status had been revoked.

It might be also added that a General Counsel Memorandum is not a notice or a ruling to taxpayers, but is merely an opinion from the General Counsel to the Commissioner

for his consideration. As stated in *Van Dyck v. Commissioner*, (9th Cir., 1941) 120 F. 2d 945: "* * * they [G. C. M.s] were merely communications from counsel to the Commissioner. The advice they contained was for the Commissioner's, not petitioner's, guidance."

While the Commissioner may generally follow the legal advice received from his counsel, it would not have been surprising if, in this instance, he had decided not to apply the ruling to automobile clubs having individual members, as in the case of petitioner, in view of his long standing position that such clubs were exempt from taxation.[31]

III.

THE STATUTE OF LIMITATIONS

A. The Statute of Limitations Started to Run on Due Date for Return.

It is submitted that the statute of limitations started to run, in the case of the year 1943, on March 15, 1944, the due date for the return for that year, and, similarly, in the case of the year 1944, on March 15, 1945, even though returns were not actually filed on those dates.

Under section 275(a) of the Internal Revenue Code of 1939 (Appendix A, p. 3a), the three-year statute of limitations commences to run from the date the return is filed. However, the courts have held that where a taxpayer is not under a duty to file a return, the three-year statute of

---

[31] In the Chattanooga Automobile Club case, 12 T. C. 976, four judges, dissenting, held that the long administrative practice with respect to the exemption of automobile clubs was such that any correction shoulld be by Congressional action, and not by judicial decision.

limitations starts running from the date the returns should have been filed if there had been a duty to file it. *Balkan Nat. Ins. Co. v. Commissioner of Internal Revenue,* (2nd Cir., 1939) 101 F. 2d 75, *Stockstrom v. Commissioner of Internal Revenue,* (App. D. C. 1950) 190 F. 2d 283.[32]

In the *Balkan Nat. Ins. Co.* case, the Commissioner mailed a notice of deficiency in 1934 with respect to the income and profits tax liabilities for the year 1918. The taxpayer, a foreign corporation, had not filed a return for the year 1918, and the Commissioner relied upon the provision of the statute which stated that the amount of the tax may be assessed at any time in case of a failure to file a return. The taxpayer had not filed a return for 1918 for the reason that in January of 1919 all of the taxpayer's assets, including its books of account and records, were seized by the Alien Property Custodian. The taxpayer claimed that the statute of limitations commenced to run on the due date for the filing of its return for the year 1918, contending it was excused from filing a return by reason of the seizure by the Alien Property Custodian of its books and records. The Second Circuit held that the statute of limitations started to run on March 15, 1919, under the circumstances of the case, for the folowing reasons:

> "While literally there has been a 'failure to file a return,' that phrase as used in section 278(a) cannot reasonably be interpreted to include a failure caused by the Government itself through seizure of the taxpayer's records. The obvious purpose of this section was to give the revenue officials unlimited

---

[32] Both Judge McAllister, in his dissenting opinion below, and Judge Goodrich, in his opinion in the Lesavoy case, supra, relied on the Stockstrom case in holding that the Commissioner was without authority to revoke retroactively the rulings of tax exemption.

time to assess and collect taxes in cases where the necessary data for determining the amount of the tax was lacking *because of the taxpayer's fault in failing to supply it in the form of a return.* * * * In *Stearns Co. v. United States*, 291 U. S. 54, 62, 54 S. Ct. 325, 78 L. Ed. 647, the Supreme Court approved the principle that 'A suit may not be built on an omission induced by him who sues.' There the principle was applied to prevent a taxpayer from relying on the statute of limitations. We believe it is equally applicable to prevent the United States from avoiding the statute."

In the case of *Stockstrom v. Commissioner of Internal Revenue, supra,* the taxpayer had made gifts in trust during the calendar year 1938, and, after consulting with the head of the Federal Estate and Gift Tax Section of the Office of the Bureau of Internal Revenue in St. Louis, did not file a gift tax return for that year for the reason that the Bureau officials advised him that no tax or return was due. Stockstrom had not been correctly advised by the Bureau officials as to the law—he had, in law, made taxable gifts in 1938. In 1948 the Commissioner issued a 90-day letter with respect to the gift tax liability for the calendar year 1938, claiming that the statute of limitations had not run since no return had been filed. The United States Court of Appeals for the District of Columbia Circuit held that the statute of limitations commenced to run on the due date for the return for the year 1938, notwithstanding that the statute provided that upon a failure to file a return the tax may be assessed at any time. In this case the Court cited the decision of the Second Circuit in *Balkan Nat. Ins. Co., supra,* and said at pages 288, 289:

"Stockstrom did not physically file a return for 1938, as we have seen. The question is, however, did he fail to file a return within the meaning of the limiting statute? Or, to put it another way, may the

Commissioner in the circumstances of this case rely upon the failure to physically file a return as destroying the period of limitation? * * * *It has already been made to appear that Stockstrom's failure to file a return for 1938 was due to the Commissioner's ruling,* made in 1938 and reaffirmed as late as 1941, *that none was required of him. The Commissioner therefore induced the omission* which he now relies upon as giving him unlimited time within which to assess a tax. * * * We conclude that Stockstrom's failure to file a return for 1938 was not the sort of failure contemplated by Par. 1016 of the Internal Revenue Code. * * * It has been well said that the government should always be a gentleman. Taxpayers expect and are entitled to receive, ordinary fair play from tax officials. *We regard as unconscionable the Commissioner's claim of authority to assess a tax in 1948 because of Stockstrom's failure to file a return for 1938, when the Commissioner himself was responsible for that failure.*" (Emphasis supplied.)

Petitioner finds itself in the same position as the taxpayer in the *Balkan Nat. Ins. Co.* case and the *Stockstrom* case. Petitioner did not file income and excess profits tax returns on the due dates for the years 1943 and 1944 for the reason that the Bureau had previously issued two rulings advising it that it was exempt from taxation and need not file returns so long as the character and nature of its organization and operation remained unchanged. There had been no change which placed the petitioner under a duty to file returns. The failure to file returns on the due dates was induced by the Commissioner—petitioner was entirely blameless.

It should be noted that the revocation letter of July 16, 1945 (R. 66, 67) recognized that petitioner on March 15, 1944 and on March 15, 1945 was not required to file income tax returns for the years 1943 and 1944, respectively.

The letter stated "you *will*" not be required to file returns for years prior to 1943—it did not say you *were* required to file, but you need not now do so. The letter stated "you *are*" required to file returns for 1943 and subsequent years—it did not state you *were* required to file returns for 1943 and 1944.

It follows that since petitioner was not under a duty to file returns on March 15, 1944 and March 15, 1945, the statute of limitations provided for in section 275(a) commenced to run on those dates. Petitioner's failure to file a return was not, as the above cases hold, a failure to file within the meaning of section 276(a) of the Internal Revenue Code of 1939 (Appendix A, p. 3a).

On August 25, 1948 petitioner did execute waivers extending the period of time for assessment of the tax for the years 1943 and 1944. But since these waivers were not executed until after the expiration of the three-year statute of limitations prescribed in section 275(a) I. R. C. the waivers were, under the provisions of section 276(b) of the Internal Revenue Code of 1939 (Appendix A, p. 3a), without legal effect.

B. Form 990 Constituted a Return for Purposes of the Statute of Limitations.

While petitioner was excused under the ruling letters of tax exemption, and under the regulations, from filing the regular income and excess profits tax return form for the years 1943 and 1944, the petitioner was required to file a return of its income on Internal Revenue Form 990, under the provisions of Section 54(f) of the code (Appendix A, p. 2a).

Petitioner filed on Form 990 a return of its gross income, receipts, and disbursements for the calendar year

1943 on August 12, 1944, and for the calendar year 1944 on May 17, 1945 (R. 20).

In the ordinary situation, it is the filing by a corporation of the return required by section 52 of the code which starts the running of the statute of limitations provided for in section 275(a) (Appendix A, p. 3a). (The provisions of sections 52 and 275 were made applicable by section 729 of the Code with respect to returns of the excess profits tax imposed during World War II.) However, this Court has held that the statute of limitations can start to run even though the corporation does not file its return pursuant to the provisions of section 52.

In the case of *Germantown Trust Company v. Commissioner of Internal Revenue* (1940), 309 U. S. 304, the taxpayer was a trust company and was taxable as a corporation. Instead of filing a corporate return on Form 1120, as required by section 52 of the Revenue Act of 1932, it filed pursuant to section 142 of that Act a fiduciary return on Form 1041, which is a return for fiduciaries taxable at the individual tax rates. This Court held, even though no corporate return had been made, that the return made on the fiduciary return form constituted a return for the purposes of the statute of limitations under section 275(a) of that Act.[33]

Similarly, the return on Form 990 filed pursuant to section 54(f) should be deemed a return for the purpose of the statute of limitations under section 275(a). Section

[33] In Commissioner v. Lane-Wells Co. (1944) 321 U. S. 219, this Court held that the filing of the regular corporation income tax return did not start the running of the statute of limitations against the surtax imposed on a personal holding company. But the corporation income tax return filed did not disclose facts from which the Commissioner could determine whether or not the corporation was a personal holding company. That type of issue is not presented by petitioner's case.

52 provides that every corporation subject to tax "shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe." (Appendix A, p. 1a.)

In the case of an organization claiming exemption from tax under section 101, section 54(f) requires the filing of "an annual return * * * stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe." (Appendix A, p. 2a.)

Thus, we have the two sections 52 and 54(f), both in part V of subchapter B of chapter 1 of the Internal Revenue Code of 1939, requiring in almost identical language the filing of returns containing substantially the same information—one section applying to corporations subject to tax and the other to exempt organizations. In view of the decision of this Court in the *Germantown Trust* case, *supra*, it should follow that a return filed pursuant to section 54(f) will qualify as a return for the purpose of section 275(a).[34]

---

[34] In Danz Charitable Trust v. Commissioner (9 Cir., 1955) 231 F. 2nd 673, cert. denied Oct. 8, 1956, — U. S. —, it was held that the filing of Form 990 did not start the running of the statute of limitations. But it can be noted that in the Danz case the Commissioner had not previously ruled that Danz was exempt from taxation. Since Danz, unlike petitioner, had not previously established its right to exemption, it was not entitled under the regulationes to rely on the provision that a return on Form 1120 need not be filed. Danz took the risk that Form 990 was the required return to be filed. Petitioner, in filing Form 990, filed the only return it was required to file under the regulations and rulings issued to it.

It appears that there has been in effect for some years an unpublished ruling of the Bureau of Internal Revenue holding that returns on Form 990 can commence the running of the statute of limitations. An official Government publication advised farmers' cooperatives as to the effect of filing a Form 990. The United States Department of Agriculture, in Miscellaneous Report No. 106 of the Farm Credit Administration, dated April 1947 and bearing the title "Preparing Federal Annual Returns for Tax Exempt Farmers' Cooperatives" advised as follows (p. 4):

> "In the case of taxable businesses, the Federal limitations statute bars the Government from making an assessment of taxes after expiration of 3 years from the date of filing an income tax return, except where the latter is fraudulently made.
>
> "While an official ruling has not been published by the Bureau of Internal Revenue, it is understood informally that the 3-year period of limitations is started in the case of tax-exempt organizations upon their filing of Form 990 provided, of course, that the return is full and complete."

Since the waiver agreements of August 25, 1948 were executed by petitioner more than three years after the filing of the returns on Form 990 for the years 1943 and 1944, the waivers were not effective to extend the statutory period of limitations provided in section 275(a).

Inasmuch as the returns filed on Form 990 for 1943 and 1944 constituted the returns for those years, the subsequent filings on October 22, 1945 of additional returns, pursuant to the Commissioner's request in his letter of July 16, 1945, are without legal significance. Those returns were filed under protest, and with no tax shown on the return. If a return is filed for a taxable year, a new or amended return subsequently filed after the due date does not start anew the running of the statute of limita-

tions. *Northern Anthracite Coal Co.,* (1931) 21 B. T. A. 1116, *Ira Goldring,* (1953) 20 T. C. 79.

In filing the Forms 990 the petitioner furnished all of the information as to its income and expenses requested by the forms. Since the Commissioner had advised the petitioner not to file a taxable return, the Commissioner is hardly in a position to allege that the information he requested on Form 990, and which was fully and completely furnished, was insufficient.

It can fairly be asked, what more is required of a taxpayer than to comply with the regulations and written instructions received from the Commissioner? Since the Commissioner informed petitioner to file only Form 990, the Commissioner should not now assert that the return so filed did not constitute a return for the year.

C. Significance of the Statute of Limitations in the Case of Tax Exempt Rulings.

In the ordinary case, a ruling which the taxpayer receives from the Commissioner does not advise him to abstain from filing income tax returns. But when the Commissioner rules that an organization is exempt from tax, the ruling (and regulations) will advise the organization—as petitioner was advised—that it should not file income tax returns so long as there is no change in its purposes or method of doing business.

In seeking an answer to the question of whether the Commisisoner has the power to revoke retroactively a tax exempt ruling, there is a very practical relationship between that question and the question as to the statute of limitations. If the answer is that the statute of limitations cannot run when a taxpayer fails to file a return in reliance on a tax exempt ruling, such an answer presents a special reason and need for holding that the Commissioner

does not have the power to revoke retroactively. On the other hand if the rule is that the Commissioner does have the power to revoke retroactively, it becomes imperative to find some protection for the taxpayer under the statute of limitations.

Certainly there must be some bounds to the extent to which the Commissioner can entrap a taxpayer by issuing a ruling of tax exempt status on which the taxpayer relies in good faith. If the Commissioner under the law has the right to revoke a ruling of tax exempt status with retroactive effect, every-day considerations of equity and fair play call for the application against the Commissioner of the rule of the *Balkan* and *Stockstrom* case, *supra,* that the statute of limitations commences to run on the due date for the filing of the return for the taxable year where the omission to file was induced by the Commissioner.

CONCLUSION

It is urged that for the foregoing reasons the judgment of the Court below should be reversed with instructions to expunge the deficiencies found below for the years 1943 and 1944 and to compute petitioner's income from membership dues in accordance with the method of accounting employed by the petitioner.

Respectfully submitted,

RAYMOND H. BERRY,
A. H. MOORMAN,
JOHN L. KING,
Attorneys for the Petitioner.

Of Counsel:

ELLSWORTH C. ALVORD,
LINCOLN ARNOLD.

Dated: January 21, 1957.

APPENDIX A

STATUTES AND REGULATIONS

INTERNAL REVENUE CODE OF 1939, AS AMENDED

Sec. 41. General Rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

Sec. 42. Period in Which Items of Gross Income Included.

(a) General Rule.—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

Sec. 52. Corporation returns.

(a) Requirement.—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information

for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice-president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. * * *

Sec. 54. Records and Special Returns.

* * * * *

(f) Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. * * *

[Section 54 (f) added to the Internal Revenue Code by section 117(a) of the Revenue Act of 1943 and is applicable to taxable years beginning after December 31, 1942.]

Sec. 101. Exemptions from Tax on Corporations.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

Sec. 275. Period of Limitation upon Assessment and Collection.

Except as provided in section 276—

(a) General Rule.—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Sec. 276. Same—Exceptions.

(a) False Return or No Return.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) Waiver.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreement in writing made before the expiration of the period previously agreed upon.

Sec. 3791: Rules and Regulations.

* * * * *

(b) Retroactivity of Regulations or Rulings.—The Secretary, or the Commissioner with the approval of the

Secretary, may prescribe the extent, if any, to which any ruling, regulations, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

REGULATIONS 86

(Under the Revenue Act of 1934)

Art. 101-1. Proof of exemption.

A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation.

In the case of the particular classes of organizations listed below, the following additional information should be embodied in or attached to, and made a part of, the affidavit referred to above:

* * * * *

(7) Clubs: The income received from the use of the facilities by the general public.

* * * * *

The collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

REGULATIONS 94

(Under the Revenue Act of 1936)

Art. 101-1. Proof of exemption.

A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the

charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization. The words "private shareholder or individual" in section 101 refer to individuals having a personal and private interest in the activities of the corporation. Although religious or apostolic associations or corporations exempt under section 101(18) are relieved from paying the tax, they are required to file returns of income (see article 101(18)-1).

In the case of the particular classes of organizations listed below, the following additional information should be embodied in or attached to, and made a part of the affidavit referred to above:

* * * * *

(7) Clubs: The income received from the use of the facilities by the general public;

* * * * *

The collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. But see article 101(18)-1 with respect to religious or apostolic associations or corporations. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

REGULATIONS 111

(Under the Internal Revenue Code of 1939)

Sec. 29.41-1. Computation of Net Income.

Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise, properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41-3. Method of Accounting.

It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. * * *

Sec. 29.101-1. Proof of exemption.

A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption under section 101 (6), Form 1023; under section 101 (1), (3), (7), or (8), Form 1024; under section 101 (9), Form 1025; under section 101 (10), (14) or (16), Form 1026; under section 101 (4), except bona fide credit unions, Form 1027; and under section 101 (12), Form 1028. All other organizations claiming exemption, including bona fide credit unions, shall file an affidavit showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

An organization claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation; provided, however, that such return shall not be required of an organization which is organized and operated exclusively for educational purposes, or educational and religious purposes, if no part of its net earnings or assets are distributable to any private shareholder in liquidation or otherwise and if, in the case of an organization privately owned or operated, the Commissioner is advised of any increase in the compensation of its owners, managers, trustees, or directors over the amount of such compensation for the last year for which its exemption under section 101 (6) was approved by the Commissioner. Form 990 will not be required of charitable organizations operated or controlled by religious or educational organizations of the type exempt under the preceding sentence from the requirement of filing such returns, nor of separately conducted charitable organizations meeting the above conditions as to distributions and compensation, nor of charitable organizations operated under the control of a State or any political subdivision thereof.

* * * * *

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward completed documents to the Comsioner for decision as to whether the organization is exempt. In addition to the information specified herein, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and

when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization exempt or claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization; * * * The return of information on Form 990 shall be filed on or before the 15th day of the fifth month following the close of the taxable year. When a mutual insurance company has established its right to exemption under section 101 (11) of the Internal Revenue Code or a corresponding provision of a prior income tax law it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or unless the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) exceeds $75,000. * * *

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

An organization which is exempt, under section 101 and the regulations thereunder, from filing returns of income is not, however, relieved from the duty of filing returns of information (see sections 147 and 148).

APPENDIX B

REVENUE RULINGS

Rev. Rule 54-164; 1954-1 C. B. 88:

> "Existing procedures clarified and certain new procedures prescribed with respect to certain organizations claiming exemption, from Federal income tax, under section 101 of the Internal Revenue Code."

• • •

Sec. 6. Review and Conferences:

> ".01 The National Office shall conduct such review of determination letters issued by District Directors' offices (including tentative determination letters)[7] as is considered necessary to assure conformity with the interpretations and policies of the Revenue Service. It is the general policy of the Internal Revenue Service to limit the revocation of a ruling with respect to an organization previously held to qualify under section 101 to a prospective application only, if the organization has acted in good faith in reliance upon the ruling issued to it and a retroactive revocation of such ruling would be to its detriment. Any ruling issued as to the exempt status of an organization will not be considered controlling where there has been a

misstatement or omission of a material fact or where the operations of the organization are conducted in a manner materially different from that represented. A revocation may be effected by a notice to the organization or by a ruling or other statement published in the Internal Revenue Bulletin applicable to the type of organization involved. The same policy will be applicable to determination letters issued by District Directors."

* * *

Rev. Rul. 54-172; 1954-1 1 C. B. 394:

"Outline of the authority and general procedures of the National Office of the Internal Revenue Service and of the offices of the District Directors with respect to issuing rulings and determination letters to taxpayers and entering into closing agreements on specific issues.

* * *

* * *

Sec. 12. Effect of Rulings:

* * *

".05 A ruling found to be in error or no longer in accord with the position of the Internal Revenue Service may be modified or revoked. Modification or revocation may be effected by a notice to the taxpayer to whom the ruling originally was issued, or by a ruling or other statement published in the Internal Revenue Bulletin. However, it is the general policy of the Internal Revenue Service to limit the revocation or modification of a ruling issued to or with respect to a particular taxpayer to a prospective application only, (a) if there has been no misstatement or omission of material facts, (b) the facts subsequently developed are not materially different from the facts on which the ruling was based, (c) there has been no change in the

applicable law, and (d) such taxpayer acted in good faith in reliance upon such ruling and a retroactive revocation would be to his detriment.

".06 With respect to rulings published in the Internal Revenue Bulletin, it is the general policy of the Service that taxpayers may rely upon such rulings in determining the rule applicable to their own transactions and need not request a specific ruling applying the principles of the published ruling to the facts of the taxpayer's particular case where otherwise applicable. See, however, .08 of this section. In the event of revocation or modification of a ruling published in the Internal Revenue Bulletin, it is the general practice of the Service to make such revocation or modification prospective only."

• • •